
Program Agenda 1

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Board & Contact 8



Wednesday, May 20, 2015

3:30 – 5:00 pm **Board of Regents Meeting**

5:00 – 6:00pm **Committee Meetings**

6:30 – 7:30 pm **Welcome Reception**

Thursday, May 21, 2015

8:00 – 9:00 am **Meet the Committee Chairs/Continental Breakfast Buffet**

9:00 – 10:00 am **Digital Invaders — Data Breaches: Risk and Insurance Coverage**
Speakers: **Lon A. Berk** Hunton & Williams LLP
Laura A. Foggan Wiley Rein LLP

10:00 – 10:10 am **Break**

10:10 – 11:10 am **What's on the Horizon for Additional Insureds?**
Speakers: **Matthew L. Jacobs** Jenner & Block LLP
Valarie Jonas Meckler Bulger Tilson Marick & Pearson LLP

11:10 – 11:25 am **Restatement: Law on Liability Update**
Speakers: **Michael Aylward** Morrison Mahoney & Miller LLP
J.W. Montgomery, III Jones Day

11:25 – 12:25pm **Reservations, Please: Recognizing and Attending to Conflicts**
Speakers: **Jill B. Berkeley** Neal, Gerber & Eisenberg LLP
Edward Currie, Jr. Currie, Johnson, Griffin & Myers

12:30 – 1:30 pm **Lunch/Recognition of New Members/Annual Business Meeting**

1:45 – 3:15 pm **What A Difference a Year Makes: 2014 & 2015 Coverage Developments**
Speakers: **Stacy A. Broman** Meagher & Geer, P.L.L.P.
Robert D. Chesler Anderson Kill & Olick

3:15 – 3:30 pm **Break**

3:30 – 4:45 pm **Catastrophe: Insurance Issues**
Speakers: **Jeffrey Pollock** Fox Rothschild LLP
William Berk Berk Merchant & Sims PLC

4:45 – 5:00 pm **Closing Remarks**

6:30 – 7:30 pm **Reception**

7:30 – 9:30 pm **Dinner**

Friday, May 22, 2015

8:00 – 9:00 am **Continental Breakfast Buffet**

9:00 – 10:00 am **Breaking Bad Behavior: Recent Developments in Insurer Bad Faith Law**
Speakers: **Lewis F. Collins, Jr.** Butler Pappas Weihmuller Katz Craig LLC
Mary E. McCutcheon Farella Braun + Martel LLP
Stephen P. Pate Norton Rose Fulbright
Alan Van Etten Deeley King Pang & Van Etten

10:00 – 11:00 am **Successfully Resolving Cases: Mediation & London Arbitration Tips From The Experts**
Speakers: **Michael Collins** Crandall, Hanscom & Collins, PA
Michael L. Manire Manire & Galla
Jed Melnick JAMS
J.W. Montgomery, III Jones Day
Hon. Layn R. Phillips Phillips ADR Enterprises, P.C.

11:00 – 11:10 am **Break**

11:10 – 11:55 am **Can I Ask You Something? Use of Special Interrogatories**
Speakers: **Troy Froderman** Polsinelli PC
Gary Johnson Richards Brandt Miller Nelson

Michael Aylward Morrison Mahoney & Miller LLP

Michael F. Aylward is a senior partner in the Boston office of Morrison Mahoney LLP where he chairs the firm's complex insurance claims resolution group. For nearly thirty years, Mr. Aylward has represented insurers and reinsurers in coverage disputes around the country concerning the application of liability insurance policies to commercial claims involving intellectual property disputes, environmental and mass tort claims and construction defect litigation. He also consults frequently on bad faith and ethics disputes and has served as an arbitrator and testified as an expert in various matters involving coverage and reinsurance issues arising out of such claims.

In addition to his trial and appellate practice, Mr. Aylward often testifies as an expert on insurance-related issues. He is also an AAA-certified neutral and has served as a party-appointed arbitrator in a number of large insurance disputes. In addition to his legal practice, Mr. Aylward is a prolific author and speaker on insurance coverage issues. He is a contributing author to several leading insurance treatises, including two chapters in the New Appleman *Insurance Law Practice Guide* (2008) and a chapter in the 2012 ABA treatise on environmental liability and insurance coverage disputes. He also publishes an e-newsletter that is circulated each Tuesday to over a thousand claims professionals and in-house counsel and is co-editor of the Insurance Law Forum blog that has been ranked among the Top 50 insurance blogs annually since it was founded in 2008.

Lon Berk Hunton & Williams LLP

Lon Berk advises clients in commercial litigation disputes, focusing on insurance matters. As an insurance litigator with more than twenty-five years of experience, Mr. Berk handles strategic client counseling, insurance program audits, writing and manuscripting policies, and, most significantly, coverage disputes in state and federal trial and appellate courts nationwide and in numerous domestic and international arbitrations. He is admitted to practice before the US Courts of Appeals for the First, Second, Third, Fourth, Eighth and Federal Circuits; and the US District Courts for the District of Maryland, District of Massachusetts, Western District of Virginia, and the Southern District of New York, and has been recognized as a leader in the field by several rankings publications. Within the insurance realm, Lon has particular experience with the resolution of disputes relating to mass torts and catastrophic events. In addition to his active practice, he speaks and writes extensively on insurance-related issues, including contributions to Appleman on Insurance Law, the ABA's Coverage publication and various law reviews.

William Berk Berk Merchant & Sims PLC

William Berk is a founding member of Berk, Merchant & Sims, PLC. For nearly thirty (30) years Mr. Berk has represented insurers in coverage, liability and bad faith disputes, and has served as an expert witness. Over his career, Mr. Berk has tried well over one hundred jury trials, and has handled appeals in the state and federal courts. Mr. Berk has lectured frequently over the past twenty years on such topics as bad faith litigation, insurance coverage law, appraisal, mold damages and coverage, ethics, and Chinese drywall.

Jill B. Berkeley Neal, Gerber & Eisenberg LLP

Jill B. Berkeley chairs Neal, Gerber & Eisenberg's Insurance Policyholder Practice Group. Described by Chambers USA in 2013 as "being recognized by her peers as a pillar of the policyholder community," Ms. Berkeley represents policyholders and claimants in insurance coverage disputes. In addition to her robust litigation practice, Ms. Berkeley offers her clients strategic advice on insurance coverage to help them manage risk. She has counseled clients in connection with all types of insurance policies, including directors' and officers' and professional liability, commercial general liability, first-party property and builder's risk, and personal and advertising injury liability. She has served as a mediator, an expert witness and is a member of the AAA Panel of Commercial Arbitrators. She is a frequent lecturer and writer of insurance-related publications including IRMI's *CGL Reporter*, IICLE's "Duty to Defend," in *Illinois Insurance Law*, and "Estoppel — Duty to Defend and Beyond," *Coverage*.

Stacy Broman Meagher & Geer, P.L.L.P.

Stacy A. Broman is a Senior Partner with the law firm of Meagher & Geer, P.L.L.P. with offices in Minneapolis and Phoenix. She is a member of the firm's Management Committee. Ms. Broman focuses her practice on complex commercial litigation where she defends insurers in insurance coverage and bad faith litigation. She regularly advises insurers on insurance coverage and regulatory matters. She also represents professionals in professional liability litigation. Ms. Broman is an active member of the Federation of Defense and Corporate Counsel (FDCC), an organization comprised of leaders in the insurance and corporate defense bar. She has chaired the FDCC's Extra-Contractual Liability Section and the FDCC's Amicus Committee. FDCC membership is selective and by invitation to those who have been judged by their peers to have achieved professional distinction. She is also a Fellow in the Litigation Counsel of America — an invitation-only honor society that limits its membership to the top 0.5 percent of trial lawyers. Fellows are selected on the basis of effectiveness and accomplishment in litigation and superior ethical reputation.

Robert D. Chesler Anderson Kill & Olick

Robert D. Chesler is a shareholder in Anderson Kill's Newark office. Mr. Chesler represents policyholders in a broad variety of coverage claims against their insurers and advises companies with respect to their insurance programs. A leading participant in the birth of modern insurance law in the early 1980s, Mr. Chesler has earned the reputation as "The Insurance Guru" for exceptional insurance coverage knowledge, and has emerged as a leader in such new areas of insurance coverage as cyber-insurance, D&O, IP, privacy and "green" insurance. Mr. Chesler has served as the attorney of record in more than 30 reported insurance decisions, representing clients including General Electric, Ingersoll-Rand, Westinghouse, Schering, BOC, Chrysler, and Unilever, as well as many small businesses including gas stations and dry cleaners. He has received numerous professional accolades, including a top-tier ranking for Insurance Litigation: New Jersey in *Chambers USA: American's Leading Lawyers for Business*, which dubs him a "top-notch attorney" and "dominant force in coverage disputes." He is also listed in *The Best Lawyers in America*, *Super Lawyers* and *Who's Who Legal* in the Insurance and Reinsurance section of the publication.

Lewis F. Collins, Jr. Butler Pappas Weihmuller Katz Craig LLC

Lewis F. Collins, Jr., is a Partner in the Tampa, Florida office of Butler Pappas Weihmuller Katz Craig, LLP. He is Board Certified in Civil Trial Law by both the Florida Bar and the National Board of Trial Advocacy, and is a Board Certified Civil Pretrial Practice Advocate. He practices primarily in the areas of bad faith, products liability, drug and wrongful death, personal injury, employment law, and professional medical device litigation, commercial litigation, liability defense. Mr. Collins served as President of: the Federation of Defense & Corporate Counsel (2005-06), Lawyers for Civil Justice (2009-10) and the Florida Defense Lawyers Association (1995-96). Mr. Collins has also served as a member of the Board of Directors of the Defense Research Institute and was Dean of the Litigation Management College at the Kellogg School of Management, Northwestern University (2001 – 2002). Mr. Collins is AAV rated, is a member of ABOTA and is a Master of the American Inns of Court. He received the 1997 Florida Defense Lawyers Presidential Achievement Award and the 1996 DRI Exceptional Performance award. Mr. Collins has been recognized as a "Leading Florida Attorney" in the field of Products Liability Defense by *Leading American Attorneys*; a "Florida Super Lawyer"; one of the "Top Attorneys in Florida: Personal Injury Defense-Products" by the *Wall Street Journal/American Registry*; and was recently recognized as one of "Tampa Bay's Top Lawyers".

Michael Collins, Q.C. Crandall, Hanscom & Collins, PA

Michael Collins Q.C. was educated in Southern Rhodesia (now Zimbabwe) and Exeter University in Devon, England, from where he graduated with an L.L.B. (Hons) (1st Class) in 1970. After taking his Bar Finals, he joined Essex Court Chambers (then 4 Essex Court), first as a pupil and then, on completion of his pupillage, as a tenant. He practiced as a barrister at the English Commercial Bar from 1972 – 2002. He was appointed Queen's Counsel in 1988, and served as a Recorder of the Crown Court between 1994 and 2001. After thirty years at Essex Court Chambers, Mr. Collins moved to the United States in 2002, joining the arbitration practice of Fulbright & Jaworski LLP, based in Washington, DC. From there he continued to practice both as an advocate and as an arbitrator. In 2006, he joined Crandall, Hanscom & Collins P.A., in order to focus specifically on his practice as an international arbitrator and mediator. He also continues to be active as an overseas member ("door tenant") at Essex Court Chambers in London. Mr. Collins has 25 years' experience of sitting as an arbitrator, and is regularly appointed in ICC, LCIA, UNCITRAL, LMAA, SIAC, ARIAS and other institutional and ad hoc cases in jurisdictions such as London, Singapore, Hong Kong, Bermuda, Canada and the United States.



Ned Currie Currie, Johnson, Griffin & Myers

Ned Currie is a founding shareholder of Currie Johnson Griffin & Myers, P.A. with offices in Jackson and Biloxi, Mississippi. A graduate of the University Of Mississippi School Of Law, he has served as an adjunct professor of law at the Mississippi College School of Law, and he has served on the faculties of the International Association of Defense and Corporate Counsel Trial Academy and the National Institute of Trial Advocacy. Representing insurers and insureds, and having tried over 175 cases to verdict, his practice has covered the range of insurance defense with emphasis on coverage and bad faith. For the past 25 years Mr. Currie has been a frequent speaker on insurance and bad faith topics. He serves on the Board of Directors of the Federation of Defense and Corporate Counsel and is past President of the Mississippi Defense Lawyers Association and the Mississippi Chapter of the Federal Bar Association. He also serves on the Mississippi Supreme Court Advisory Committee for the Rules of Civil Procedure.

Laura Foggan Wiley Rein LLP

Laura Foggan chairs Wiley Rein's Insurance Appellate Practice. She is a nationally-recognized insurer counsel with 20+ years' experience litigating general liability, professional liability and other coverages. She regularly represents insurers in disputes over insurance coverage for privacy and data breach, environmental and toxic tort, product liability, construction, personal and advertising injury, and in bad faith claims. Ms. Foggan has participated in over 200 insurance appeals nationwide, including many cases creating key insurance precedents. In addition to her litigation work, she assists insurers in drafting policy forms and endorsements. Ms. Foggan regularly counsels insurers on emerging risks and opportunities, including climate change, cyber-liability, and insurer interests in unmanned aircraft systems (UAS or, more commonly, drones). A past co-chair of the ABA Litigation Section Insurance Coverage Litigation Committee, Ms. Foggan is a member of the American College of Coverage and Extracontractual Counsel, and has been described by *LawDragon 500 Magazine* as "one of the most successful advocates for the insurance industry to ever practice" and named one of *Law360's* "10 Most Admired Insurance Attorneys," among many other honors.

Troy B. Froderman Polsinelli PC

Troy Froderman has represented corporate policyholders in business disputes with insurance carriers for more than 25 years. His practice extends to a multitude of insurance lines, and he litigates cases for corporate policyholders on a national and multinational basis. He chairs the firm's Insurance Recovery practice. As the immediate past chair of the firm's Environmental practice, he has litigated CERCLA and environmental matters from coast to coast. He is also the chair of the firm's Pro Bono Committee, and is passionate about serving the needs of those individuals who are desperate for legal aid.

Matthew L. Jacobs Jenner & Block LLP

Matthew L. Jacobs has been successfully litigating insurance coverage matters for more than 25 years, and he handles complex, multi-party insurance coverage matters in state and federal courts. While corporations seek Mr. Jacobs' counsel on the availability of insurance coverage for a wide variety of claims, he also advises companies in the placement and renewal of various types of insurance coverage, including directors and officers policies and cyber insurance. Mr. Jacobs is a member of the firm's Insurance Recovery and Counseling, Reinsurance, and International Arbitration Practices. He is a member of the firm's Alternative Fee Billing and International Committees. He has published and lectured widely on insurance coverage topics and has been quoted extensively on developments in insurance law in national publications, television and radio. In 2014 and 2015, Mr. Jacobs was a guest lecturer in the "Insurance Law and Policy" class at the University of Pennsylvania Law School. He is the author or co-author of more than 75 papers and articles and has spoken at more than 100 insurance coverage conferences during his career.

Gary L. Johnson Richards Brandt Miller Nelson

Since joining Richards Brandt Miller Nelson in 1984, Mr. Johnson's practice has included work in bad faith litigation and insurance coverage. His litigation work encompasses both first party and third party claims, with a special emphasis on the CGL coverage form. In addition to his membership in the ACCEC, he serves in the International Association of Defense Counsel and he is the Utah State Representative for the Defense Research Institute.

Valarie Jonas Meckler Bulger Tilson Marick & Pearson LLP

Valarie Jonas is a partner in the San Francisco office of Meckler, Bulger, Tilson. For more than 25 years she has represented foreign and domestic insurers in first- and third-party insurance coverage disputes, bad faith and complex commercial litigation. Ms. Jonas is frequently asked to speak before her peers and clients in both the United States and Europe on a wide variety of insurance and litigation issues.

Michael L. Manire Manire & Galla

Mike Manire's practice has focused on insurance since 1993, when he joined D'Amato & Lynch. He founded his new firm, Manire & Galla LLP, with a colleague in 2015. Mr. Manire has represented global D&O, E&O and professional liability insurers in connection with complex claims on policies issued both in the U.S. and abroad. He has represented insurers in coverage and bad faith litigation, but his 20 years of experience in dispute resolution and mediation has led him to a particular interest and expertise in exploring and reaching resolution. Mr. Manire has participated in settlements of both coverage and underlying liability issues in hundreds of matters, including securities fraud class actions, shareholder derivative actions, creditors' committee and bankruptcy trustee claims, breach of fiduciary duty claims, consumer class actions, employment liability actions, bankers' and investor advisors' liability claims, media and intellectual property claims, and a variety of other professional and management negligence claims.

Mary E. McCutcheon Farella Braun + Martel LLP

Mary McCutcheon represents corporate and individual policyholders in a wide variety of insurance coverage disputes. Chambers USA recognizes Ms. McCutcheon as one of the leading insurance attorneys in California. She has also been recognized in *Northern California Super Lawyers* as one of the Top 50 Women Lawyers for the past several years. She is listed in *The Best Lawyers in America* in the area of Insurance Law and is a founding member of the American College of Coverage and Extracontractual Counsel. Her wide-ranging experience includes coverage disputes arising out of: securities investigations, class actions and derivative actions; intellectual property and technology errors and omissions lawsuits; highly sensitive employment claims; mass casualty personal injury actions; construction defect claims; and aviation and other products liability lawsuits. She also represents companies in business interruption and property damage claims arising out of natural disasters such as earthquakes and fires.

Jed D. Melnick JAMS

Jed D. Melnick, Esq. has been involved in the mediation and successful resolution of hundreds of complex disputes with an aggregate value in the billions of dollars. He has mediated over 750 disputes, published articles on mediation, founded a nationally ranked dispute resolution journal and taught young mediators. Mr. Melnick serves as a mediator, appointed by Judge Kaplan, in the Lehman ADR Derivative Contract Program. He is the managing partner for Weinstein Melnick LLC, working alongside the Hon. Daniel Weinstein (Ret.), one of the nation's preeminent mediators of complex civil disputes. In 2010, 2011 and 2012, Mr. Melnick was selected as a *Pennsylvania Super Lawyers* "Rising Star," the only "Rising Star" in the Alternative Dispute Resolution category in Pennsylvania. He was also selected to the 2010 list of Pennsylvania "Lawyers on the Fast Track," a recognition given to 30 Pennsylvania Lawyers under the age of 40 by *Legal Intelligencer* and the *Pennsylvania Law Weekly*.

J.W. Montgomery III Jones Day

Jack Montgomery's practice focuses exclusively on insurance coverage advice, litigation, and arbitration. He handles insurance coverage litigation in various jurisdictions and national and international insurance arbitrations. As lead counsel, Mr. Montgomery recently tried to conclusion three insurance arbitrations, two in London and one in the United States. He is also representing Transocean in connection with the Deepwater Horizon/Macondo well incident insurance issues. Other representative clients include Occidental Petroleum, Occidental Chemical, GE, GM, Motorola Solutions, PepsiCo, Macy's, and Air Products and Chemicals among others. He regularly serves as an arbitrator in London-based, Bermuda-based, and domestic insurance arbitrations. For 24 years, he has been an adjunct professor at the University of Pittsburgh School of Law, teaching substantive courses on insurance law.



[Stephen P. Pate](#) Norton Rose Fulbright

Stephen Pate has tried over 45 first party and extracontractual cases to verdict over a 28 year career in coverage work. Mr. Pate has handled property insurance, Business Interruption issues, Directors and Officers insurance matters, commercial general liability insurance disputes and a host of other policy related work in Texas and other states for 28 years.

[Honorable Layn R. Phillips](#) Phillips ADR Enterprises, P.C.

Layn R. Phillips, founder of Phillips ADR Enterprises (PADRE), is both a former United States Attorney and a former United States District Judge. Judge Phillips joined the United States Attorney's office in Los Angeles in 1980 as an Assistant United States Attorney, serving as a federal prosecutor in the Central District of California for four years. During the Reagan administration, he returned to his home state of Oklahoma, where, at age 31, he was nominated to serve as a United States Attorney. At age 34, he again was nominated by President Reagan to serve as a United States District Judge in Oklahoma City. During his four years on the bench, he presided over more than 140 federal trials in Oklahoma, New Mexico, and Texas. He also sat by designation on the United States Court of Appeals for the Tenth Circuit in Denver, Colorado, where he participated in numerous panel decisions and published multiple opinions. For his years of commitment to public service, in 1989 he was named as one of the 10 Outstanding Young Americans by the U.S. Junior Chamber of Commerce. In 1991, he resigned from the federal bench and joined Irell & Manella, where for 23 years he specialized in complex civil litigation, internal investigations, and alternative dispute resolution. As a result of his trial work, in 1997 Judge Phillips was elected into the American College of Trial Lawyers. He has the dual honor of being named by *Law Dragon* in 2006 as one of the "Leading Judges in America" and as one of the "Leading Litigation Attorneys in America."

[Jeffrey M. Pollock](#) Fox Rothschild LLP

Mr. Pollock focuses his practice on complex litigation, environmental law, and policyholder representation. He is recognized as a leading environmental lawyer by Chambers USA and was certified by the New Jersey Supreme Court as a Civil Trial Lawyer. This certification is bestowed by the court upon select attorneys who demonstrate sufficient levels of experience, education, knowledge, and skill in a specific area of law or practice and who have been recognized by their peers as having sufficient skills and reputation in the designated area of law, among other requirements.

[Alan Van Etten](#) Deeley King Pang & Van Etten

Alan Van Etten has written and spoken extensively on insurance law and litigation. In 1993 and 1994, at the Law School's request, he was Adjunct Professor (Advanced Torts/Insurance Law) at the University of Hawaii's School of Law. He frequently speaks, writes, and teaches on the subject of Hawaii Insurance Law; he has co-written the materials for, and been a panel presenter on, more than thirty insurance coverage and bad faith seminars since 1997. Attendees at the seminars are other attorneys and insurance professionals. Because his teachings contribute significantly to establishing the standard of practice of insurance claims handling in the State of Hawaii, he serves as an expert witness on that standard for both insureds and insurers. He co-founded the Insurance Coverage Litigation Section of the HSBA in 2006, was its first chairperson, and is currently its co-chair. For many years he served as a Vice-Chair of the Insurance Coverage Litigation Committee (ICLC) of the Tort & Insurance Practice Section of the ABA. He was its Program Chair for ICLC's Annual Meeting in February, 2009. He is the only attorney licensed to practice law in Hawaii who has been chosen to be a Fellow of the American College of Coverage and Extracontractual Counsel, an invitation-only entity which, according to its mission statement, is composed of preeminent insurance coverage and extracontractual counsel in the United States and Canada, representing the interests of both insurers and policyholders.

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Review of CGL Coverage Issues Posed in Cyber and Data Breach Claims

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General Liability – Overview

Policyholders seek to obtain CGL coverage not only for private suits following a data breach, but also for their substantial exposures under agreements that may allow credit card processors such as Visa, Discover and MasterCard to impose charges on them in the event of a data breach.

Courts have split on these issues.

Both Coverage A (Property Damage) and Coverage B (Personal and Advertising Liability) are being tested in litigation.

General Liability – Coverage A

Most CGL policies afford coverage for “those sums that the insured becomes legally obligated to pay as damages because of ... ‘property damage’ to which this insurance applies.”

“Property damage” is defined to mean “physical injury to tangible property, including all resulting loss of use of that property” and “loss of use of tangible property that is not physically injured.”

Coverage A

Under CGL policies issued before 2001, a split of authority existed as to whether electronic data constituted “tangible property.”

- *Am. Online, Inc. v. St. Paul Mercury Ins. Co.*, 207 F. Supp. 2d 459, 466 (E.D. Va. 2002) (“Computer data is not tangible property.”), *aff’d*, 347 F.3d 89 (4th Cir. 2003).
- *State Auto Prop. & Cas. Ins. Co. v. Midwest Computers & More*, 147 F. Supp. 2d 1113, 1116 (W.D. Okla. 2001) (“Alone, computer data cannot be touched, held or sensed by the human mind; it has no physical substance. It is not tangible property.”).
- *Computer Corner, Inc. v. Fireman’s Fund Ins. Co.*, 46 P.2d 1264 (N.M. Ct. App. 2002) (finding coverage for suit for loss of data from reformatting hard drive; “computer data is tangible property”).
- *Am. Guar. & Liab. Ins. Co. v. Ingram Micro, Inc.*, No. CIV. 99-185 TUC ACM, 2000 WL 726789 (D. Ariz. Apr. 18, 2000) (concluding that loss of data on computer network constituted “property damage”).

More recently-issued CGL policies specifically provide that “electronic data is not tangible property.” *See* ISO Form No. CG 00 01 10 01 (added in 2001).

Coverage A

Note that under some policy forms loss of use of computers or other property may trigger “loss of use” prong of “property damage” definition, according to at least one ruling.

For instance, a claim seeking damages for loss of use of tangible property was found to be covered in *Eyeblander, Inc. v. Federal Insurance Co.*, 613 F.3d 797 (8th Cir. 2010), where a computer allegedly was rendered unusable due to spyware.

Coverage A

However, more recent CGL policies eliminate coverage for “[d]amages arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data.” *See* ISO Form No. CG 00 01 12 04 (added in 2004).

Assuming this exclusion is applied as written, Coverage A should not afford coverage under post-2004 policies with this exclusion regardless of how the definition of “property damage” is construed.

Coverage A

Some policyholder advocates have suggested, however, that claims involving privacy exposures may involve “loss of use” of credit cards, and the law on this issue is unsettled.

- *Pennsylvania State Emps. Credit Union v. Fifth Third Bank*, No. 1:CV-04-1554, 2005 WL 1154594, *10 (M.D. Pa. May 3, 2005) (“[T]he credit and debit cards are tangible personal property.”).
- *Sovereign Bank v. BJ’s Wholesale Club, Inc.*, 533 F.3d 162, 179-80 (3d Cir. 2008) (“The fraudulent transactions had no physical effect on either the cards, the data encoded on the cards, or the magnetic-stripe which contained that data. The fraudulent activity simply did not render the cards useless. The cardholders could continue to use them to make purchases after the information was compromised. Indeed, as [one party] notes, [the other party] deemed the cards useless not because they were damaged, but because [the party] was exposed to liability for unauthorized charges.”).

General Liability – Coverage B

Policyholders have also sought coverage under “Coverage B,” which covers “those sums that the insured becomes legally obligated to pay as damages because of ‘personal and advertising injury.’”

“Personal and advertising injury” is defined to mean “injury ... arising out of one or more of the following offenses:

- ... [o]ral or written publication, in any manner, of material that violates a person's right of privacy.”

Key words/ phrases:

- “injury ... arising out of one or more of the following offenses: ... [o]ral or written publication, in any manner, of material that violates a person’s right of privacy.”

Coverage B

Early litigation testing whether privacy-related claims can fall under the offense of “oral or written publication of material that violates a person’s right to privacy” involved claims brought under the Telephone Consumer Protection Act of 1991 (TCPA), the Fair and Accurate Credit Transactions Act (FACTA), the Fair Credit Reporting Act (FCRA), and California’s Song-Beverly Act addressing, *inter alia*, “blast fax” transmissions to persons’ homes or businesses, issuance of debit and credit card receipts with non-truncated account numbers or expiration dates, and the use of zip codes in credit card transactions.

Coverage B

Policyholders also are testing whether claims arising from a data breach can fall under the “personal or advertising injury” coverage found in CGL policies.

There are many coverage issues posed by these cases, and the early court rulings are mixed.

Coverage B

There are serious questions in whether a data breach event meets the “Personal and Advertising Injury” requirement of a “publication” that violates a person’s right to privacy.

For instance, a “publication” requires communication to another, or even to the public at large. In a data breach, often consumer data is obtained in the first instance only by hackers.

Some cases, however, hold that any disclosure of information can constitute a “publication” within the meaning of CGL policies – even disclosure to a single person. And, there are important variations in policy language (e.g., “publication” vs. “making known to any person or organization”).

Coverage B

Coverage B torts require a voluntary, affirmative, and even intentional action on the part of the insured, instead of a mere failure to protect information followed by the hacker's theft. *See, e.g., Gregory v. Tennessee Gas Pipeline Co.*, 948 F.2d 203, 209 (5th Cir. 1991) (enumerated prongs of Coverage B “require[] active, intentional conduct by the insured”).

A retailer takes no such affirmative, volitional act when its data is stolen by hackers. Policyholders thus will be testing whether and in what contexts the passive, allegedly negligent conduct of a retailer in “allowing” a data breach can be sufficient to trigger coverage. For example, policyholders may argue that “phishing” or “Trojan Horse” attacks – which require some act on the part of the policyholder – involve intentional acts that could trigger coverage, even if there is no intentional policyholder act in other breach settings. They will also contend that there need not be intentional action by the policyholder.

Coverage B

Some of the suits following a data breach may not seek damages because of “publication” that violates a “person’s right to privacy” at all.

Almost every U.S. state has enacted legislation requiring entities victimized by data breaches to disclose those breaches to affected consumers. At least one of the suits against Target is directed at Target’s failure to notify individuals who were the subjects of the data breach, and subsequent suits are likely to arise under these grounds. As a result, these suits may arise out of the failure of the retailer to provide required information to consumers, rather than directly out of any alleged “publication.”

Coverage B

Also, some liability in data breach or privacy violation suits may not qualify as “damages” within the meaning of CGL policies.

- As an example, many courts have held that statutory penalties are not such “damages,” although there is a debate as to what constitutes a “penalty” and what constitutes compensatory damages.
- Data breaches can invite scrutiny from state attorneys general, who could seek fines or penalties that fall outside of CGL insuring agreements. For instance, the breach at TJ Maxx led to a \$9.75 million settlement with the attorneys general of 41 states.
- In addition, certain amounts claimed by credit card companies in the event of a credit or debit card breach may not qualify as “damages” but rather fees or costs of doing business.

Coverage B

Many existing CGL policies contain exclusions which limit or bar coverage for the violation of statutes. A recent ISO exclusion prohibits coverage for claims arising from any statute that “addresses, prohibits, or limits the printing, dissemination, disposal, collecting, recording, sending, transmitting, communicating or distribution of material or information.” *See* ISO Form No. CG 00 68 05 09 (added in 2009).

Most states have legislation similar to California’s Security Breach Notification Act, which requires businesses to disclose a breach to a person “without unreasonable delay” after their “unencrypted personal information” was acquired by an “unauthorized person.” Cal. Civ. Code § 1798.82 (West). A strong argument can be made that these statutes address or limit the dissemination and collection of material or information and thus any claims arising out of violation of their terms fall within this exclusion.

Coverage B

ISO issued a set of exclusions to be included in CGL policies in May 2014 that bar coverage for claims “arising out of any access to or disclosure of any person’s or organization’s confidential or personal information” as confirmative of the intent that CGL policies are not written to cover suits arising from data breaches.

However, this exclusion may take some time to make its way into CGL policies and – even after it has been utilized – policyholders undoubtedly will seek to litigate the scope of this exclusion in specific instances.

Coverage B

The early cases addressing data breach, privacy and other cyber claims under CGL coverage are mixed.

To the extent coverage is found, it has been limited to certain fact settings and to certain types of exposures. CGL coverage plainly does not encompass all data breach, privacy and cyber losses – even when courts find some coverage.

Coverage B

Travelers Indem. Co. v. Portal Healthcare Solutions, LLC, No. 1:13-cv-00917-GBL-IDD (E.D. Va. Aug. 7, 2014).

- Insured allegedly posted “confidential medical records” on a public website, and patients (who later sued) alleged that they were able to access those records by way of a simple Google search.
- Court ruled that there was “publication” because the records were “place[d] before the public” and it rejected the insured’s argument that it did not intend to publish the information.
- The court also ruled that the posting of the records without security restriction could give “unreasonable publicity” to and cause “disclosure” of information about patients’ private lives, rejecting the insurer’s argument that information could only be “disclosed” if it were viewed by third parties.
- The case currently is on appeal before the Fourth Circuit.

Coverage B

Zurich Am. Ins. Co. v. Sony Corp. of Am., No. 651982/2011 (N.Y. Sup. Ct. Feb. 21, 2014).

- Sony’s PlayStation Network was hacked in April 2011. The hackers stole personally-identifiable information of over 77 million users, one of the largest data breaches in history.
- Sony argued that hackers’ theft of personal information fell within the Coverage B offense of “oral or written publication in any manner of material that violates a person’s right of privacy.”
- The court ruled that coverage was not triggered where the “publication” offense was not an intentional act committed by the insured, but instead was the result of a criminal act of a third party hacker. The offense requires “an act by or some kind of act or conduct by the policyholder in order for coverage to be present,” it held.
- The case settled while on appeal to New York intermediate appellate court.

Coverage B

Recall Total Mgmt., Inc. v. Fed. Ins. Co., 83 A.3d 664 (Conn. Ct. App. 2014)

- Insured transport vendor allegedly lost data tapes containing sensitive data on a large number of employees. Those tapes allegedly were recovered by a third party, but there was no evidence that the information on the tapes was ever accessed. The main “damages” sought were the costs of notification and remedial measures allegedly taken by the party who owned the data tapes.
- Court ruled that there was no “publication” absent evidence that information on the tapes was ever accessed, noting that the communication of information to a third party was required to trigger coverage.
- The case is currently on appeal to Connecticut Supreme Court.

Questions?



Insuring Cyber Risks

- Involve relevant stakeholders
- Analyze business exposures
- Review existing coverages
- Examine proposed forms
 - Are there gaps?
 - Are there overlaps?
 - Do they match your risk profile?
 - Who selects vendors?

The Scope of the Risk

	CAUSE	LOSS
1	cyber	cyber
2	brick and mortar	cyber
3	cyber	brick and mortar
4	brick and mortar	brick and mortar

Cyber Policies: Possible Coverages

- Privacy and Network Security Liability
- Network Interruption and Extra Expense
- Media Liability
- Information Assets
- Regulatory
- Remediation
- Extortion

Privacy and Network Security

- Typically covers on a claims made basis liability from data breaches, transmission of malicious code, denial of third-party access to the insured's network and other network security threats
 - *Universal Am. v. Nat'lional Union Fire Insurance Company* (NY App. Div. 2013)
 - Efficient Services Escrow Group
 - <http://krebsonsecurity.com/2013/08/1-5-million-cyberheist-ruins-escrow-firm/>

Network Interruption and Extra Expense

- Protects against loss of income and extra expense resulting from interruption of insured's ability to access networks
 - “Your network” may not include networks on which you rely
 - New York Times/Syrian Electronic Army example
 - The Cloud
 - Vendors

Outstanding Insurance Issues

- Pre-existing circumstances
 - The Retro Date and claims made coverage
 - Gaps between hacking intrusion and data extrusion
- Trigger of coverage
 - Discovery of breach vs occurrence of breach
 - Wrongful act vs security event

Outstanding Insurance Issues

- Terrorism and war exclusions
 - War or warlike operations
 - Uprising
 - Military or state actors
 - Acts of foreign enemies
 - Popular uprising or political disturbance
 - Insurrection, rebellion
 - Acts to defend against the above

Outstanding Issues

- Government Seizure and Confiscation
Exclusion
 - arising out of governmental seizure, confiscation, nationalization, breach of security, use, misuse or destruction of systems or data

Operational risks

- The challenge of ICS
 - Bodily injury and property damage
 - Physical vs. cyber security

What's On The Horizon for Additional Insureds?

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May 21, 2015

Definition of Additional Insured

- **“A person or organization not automatically insured as an insured under an insurance policy, but for whom insured status is arranged, usually by endorsement. ...”**

Iirmi Online – Glossary of Insurance and Risk Management Terms

Consider the Additional Insured

- Stand in the same shoes as the Named Insured
- Often the same rights and responsibilities
- The duty to defend that is broader than the duty to indemnify – and immediate!
- AI's sole negligence may be covered by the policy
- May be entitled to certain policy communications
- Additional insureds are in privity with the carrier.

Benefits for Additional Insured

- Coverage without premium.
- No loss history.
- Doesn't erode additional insured's own policy limits of liability.
- No responsibility for deductibles.
- May provide broader coverage than contractual indemnity.
- Particularly important for companies who are self-insured or who have retentions on their own policies.

Benefits for Additional Insured (cont.)

- Supports indemnity obligation, which only has value if the indemnitor has assets to fulfill it.
- Defense coverage, without having to wait for a resolution of the indemnity obligation.
- Can be independent of, and provide broader protection than, the indemnity obligation, i.e., for the additional insured's negligence.
 - Important where applicable state's law prohibits indemnification of one's own negligence.

Disadvantages for Additional Insured:

- No control over the defense.
 - Significant where both the Named Insured and Additional Insured are sued.
- Limits must be shared among all insureds.
- Often no business relationship with Named Insured's carrier.
- Policy may not provide complete indemnity or may provide less than contracted for limits.
- Potential coverage litigation.

Implications for Named Insured

- **Pros**

- Allows transfer of the obligation to defend and indemnify the indemnitee to the insurer.

- **Cons**

- Erosion of limits.
- Limits shared by all insureds.
- Limits used to pay claims for which the Additional Insured may be partly or entirely at fault.
- Responsibility for deductible.
- Higher premiums down the road based on loss experience.

Potential Cons to both Additional Insured and Named Insured

Suit against insured and AI can raise conflict of interest for insurer requiring separate counsel. Limits may erode with defense of multiple parties.

Payment of judgment or settlement as to one party may use up the applicable limit of insurance in a liability policy, thereby ending insurer's right and duty to defend.

How Does One Become An Additional Insured?

- Endorsement specifically names additional insured on schedule.
- Contract for AI coverage with policy blanket endorsement (grants AI status to entities the Named Insured is contractually required to insure or to enumerated categories of Additional Insureds)
- Policy definition of “Insured” / “Who is an insured?”

The Contract

- An obligation to indemnify does not confer additional insured status.
- Does the contract contain an insurance provision?
 - Does it require that the other party name your client as an additional insured?
 - Does it specify the type and amount of insurance coverage to be provided?
 - CGL, Umbrella?
 - Primary or Excess?
 - Limits?

The Insurance Policy

- A contractual obligation to provide insurance is ineffective unless the Named Insured's policy contains an Additional Insured Clause.
- Usually in an endorsement.

Importance of Certificate to AI Coverage

- Confers no rights; matter of information only
- *Cincinnati Insurance Co. v. Vita Food Products*, 2015 WL 426269 (N.D. Ill. 2015) (Additional insured status turned on whether certificate of insurance naming AI was issued prior to or after the incident that gave rise to the claim occurred.)
- *In re Deepwater Horizon, Relator (infra)*, 2015 WL 674744 (S.Ct. Tex. 2015) (where there is no certificate of insurance naming an additional insured, policy may require reference to the underlying contract to determine entity's status as an additional insured.)

Types of Additional Insured Endorsements

- Both ISO endorsements and manuscript endorsements. Two varieties:
 - Blanket additional insured endorsements -- grant additional insured status to categories of Additional Insureds or to those whom the Named Insured has a contractual obligation to insure.
 - Sometimes called automatic additional insureds.
 - If the contract does not specifically require insurance, the endorsement is ineffective.
 - Scheduled additional insured endorsements – lists the name of the additional insured.

Verifying Additional Insured Coverage

- A certificate of insurance is not proof of insurance.
- The Acord form specifically states that additional insured coverage requires an endorsement.
 - See specific wording.

Verifying Additional Insured Coverage (cont.)

- Ideally, request a full copy of the Named Insured's policy.
- May not be that simple.
 - For some large companies, the extent of their insurance program, including limits and deductibles, is a closely-guarded secret.
 - In that situation, review the additional insured endorsement(s), at a minimum.
 - Review the Other Insurance Clause, if possible.

Scope of Additional Insured Coverage

- How broad is it?
- Does it essentially back-stop the Named Insured's contractual indemnity obligation?
 - Which clause appears first in the contract – indemnity or insurance?
- Does it cover more than the Additional Insured would be able to recover under the Indemnity Agreement?
 - What if the indemnity agreement contains a monetary cap?
 - What if the insurance provision states that that the Additional Insured will receive coverage in the minimum amount of \$ _____?

Scope of Additional Insured Coverage

- What if the indemnity agreement is unenforceable?
 - For example, an agreement that purports to indemnify the indemnitee for its own negligence?
 - In a state where such an agreement is void as against public policy?

Impact of Anti-Indemnity Statutes on Additional Insured Coverage

- Recently, some states (e.g., California, Colorado, Kansas and New Mexico) have enacted legislation prohibiting coverage for the additional insured's own negligence where that negligence could not be transferred via an indemnity agreement.
- In states where additional insured status is within the jurisdiction of the anti-indemnity statute, an additional insured's coverage cannot be broader than its protection as an indemnitee.

The 2004 Amendments to ISO's Endorsements

- In response to these cases, in 2004, ISO amended some of its commonly-used additional insured endorsements to make clear that the additional insured's sole negligence is not covered.
- Additional Insured only has coverage with respect to liability for BI or PD caused, in whole or in part, by the Named Insured's conduct.

CG 20 10

- The ISO CG 20 10 is the most common insurance form used to list additional insured interests on general liability policies.

ISO Endorsement Numbers:

CG 20 10 10 93

CG 20 10 03 97

CG 20 10 07 04

- Who is an insured is amended to include ... the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured
- Coverage ended when the named insured's operations ended.

CG 20 10 07 04 – Narrowed Further to “Acts or Omissions”

- **Section II. Who Is An Insured** is amended to include an additional insured the ... organization(s) shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured, for “bodily injury,” “property damage” or “personal and advertising injury” caused, in whole or in part, by:
 - Your acts or omissions; or
 - The acts or omissions of those acting on your behalf; in the performance of your ongoing operations for the additional insured...

The 20 10 07 04 Endorsement

- Eliminates “arising out of” language which provided coverage to the additional insured for its own fault if the work was related to the operations of the named insured;
- There must be some causal connection between the named insured’s ACTS OR OMISSIONS and the tort liability of the additional insured;
- What that means has yet to be decided by most of the highest courts in the land.

20 10 07 04 Endorsement (cont.)

- Eliminates coverage for the additional insured based on its sole negligence;
- Looks to negligence of named insured, not relevant in previous endorsements;
- Consider the allegations in the complaint.

The 20 10 04 13 Version is Different

- **Section II – Who Is An Insured** is amended to include as an additional insured the person(s) or organization(s) shown in the Schedule, but only with respect to liability for “bodily injury,” “property damage” or “personal and advertising injury” caused, in whole or in part, by:
 - Your acts or omissions; or
 - The acts or omissions of those acting on your behalf; In the performance of your ongoing operations for the additional insured(s) at the location(s) designated above.

However:

- The insurance afforded to such additional insured only applies to the extent permitted by law; and
- If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which you are required by the contract or agreement to provide for such additional insured.

Impact of 2013 ISO Changes to Standard CGL Forms on AI Coverage:

1. Scope of coverage limited to what is contractually required;
2. Provides coverage only to extent allowed by law;
3. AI coverage does not require direct contract between Named Insured and Additional Insured.

Privity: Still Necessary?

- *Zoological Society of Buffalo v. Carvedrock LLC*, 2014 WL 3748545 (W.D. N.Y., 2014)
 - Endorsement expressly provided that additional insureds included only those with whom the Named had entered into a written contract.
 - Because owner had no direct contract with subcontractor on construction site, owner was not entitled to AI status under sub's policy in lawsuit filed against owner and general contractor arising out of sub's employee's personal injury.

Revised CG 20 10 Does Not Limit Coverage to Vicarious Liability

- ***American Empire Surplus Lines Ins. Co. v. Crum & Forster Specialty Ins. Co.***, No. H-06-004, 2006 U.S. Dist. LEXIS 33556 (S.D. Tex May 23, 2006) (language of endorsement requiring that Additional Insured's liability arise, in whole or in part, out of Named Insured's conduct, does not limit coverage to vicarious liability, but provides coverage where both Named Insured and Additional Insured are negligent).

- *But see King Cole Condominium Association v. Mid-Continent Cas. Co.*, 21 F.Supp.3d 1296 (S.D. Fla. 2014)
 - Policy defined insured as “the person or organization shown in the Schedule, but only with respect to liability directly attributable to your performance of ongoing operations for that insured.”
 - Condominium association entitled to AI coverage in action by condo owner against association and general contractor only to extent the condo association had been sued for vicarious liability resulting from negligence of general contractor, as named insured. (Underlying action must allege vicarious liability.)

Tendering A Claim As An Additional Insured

- Request a copy of the entire policy, if necessary.
- Give prompt notice of any incident to that carrier on whose policy the client is an additional insured.

Tendering A Claim As An Additional Insured (cont.)

- Also put client's own carrier on notice.
 - Advise the carrier that you have also tendered the claim to another carrier as an additional insured and that at the present time, the notice is for informational purposes.
 - Check the notice provisions to be sure that this type of notice doesn't violate the policy conditions.
- This avoids a late notice defense by client's own carrier in the event additional insured coverage is denied or the policy limits are insufficient.

In re Deepwater Horizon, Relator, No. 13-0670, Supreme Court of Texas

- On Certified Questions from the US Court of Appeals for the Fifth Circuit
- Decided February 13, 2015 by an 8-1 ruling
- Opinion by Justice Guzman
- Dissent filed by Justice Johnson

Ruling

- **Question:** Can BP access Transocean's \$750 million of insurance coverage as an additional insured for *subsurface pollution* stemming from the Deepwater Horizon oil spill?
- **Answer:** After analyzing the drilling contract between BP and Transocean, the court concluded that BP's coverage as an additional insured was limited to the liabilities Transocean assumed under the contract, which related only to *above-surface pollution*.

Procedural Background

- Why was the Texas Supreme Court looking at an issue that had been before the United States Court of Appeals for the Fifth Circuit?
- The Court of Appeals Certified two questions that had not previously been addressed by the Texas Supreme Court.
- The Fifth Circuit originally ruled in BP's favor and held that there were no limitations in BP's coverage under the Transocean policies because it did not look at any documents outside of the policy's "four corners."
- On rehearing, the Fifth Circuit withdrew its prior decision and certified two questions to the Texas Supreme Court to answer.

Four Key Holdings:

1. “The Transocean insurance policies include language that necessitates consulting the drilling contract to determine BP’s status as an additional insured;”
2. “Under the terms of the drilling contract, BP’s status as an additional insured is inextricably intertwined with limitations on the extent of coverage to be afforded under the Transocean policies;”
3. “The only reasonable construction of the drilling contract’s additional-insured provision is that BP’s status as an additional insured is limited to the liabilities Transocean assumed in the drilling contract; and”
4. “BP is not entitled to coverage under the Transocean insurance policies for damages arising from subsurface pollution because BP, not Transocean, assumed liability for such claims.”

Additional insured language in the drilling contract:

- The drilling contract required Transocean to carry multiple types of insurance at its own expense.
- Transocean was charged with naming BP, its affiliates, officers, employees, and a host of other related individuals and entities:
 - as additional insureds in each of [Transocean’s] policies, except Workers’ Compensation for liabilities assumed by [Transocean] under the terms of [the Drilling] Contract.

- Consistent with long-standing precedent regarding the relationship between the duties to indemnify and to provide additional insured status, the court found that:
- “The drilling contract required Transocean to name BP as an additional insured only for the liability Transocean assumed under the contract.”
- “Accordingly, Transocean had separate duties to indemnify and insure BP for certain risk, but the scope of that risk for either indemnity or insurance purposes extends only to above-surface pollution.”

First certified question:

- Whether *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660 (Tex. 2008), compels a finding that BP is covered for the damages at issue, because the language of the umbrella policies alone determines the extent of BP's coverage as an additional insured if, and so long as, the additional insured and indemnity provisions of the Drilling Contract are "separate and independent"?
- This was BP's argument in favor of its additional insured position. Do not look outside of the four corners of the umbrella insurance policies, and do not refer to the Drilling Agreement as part of the analysis.

- BP argued under *Atofina* that the scope of AI coverage is determined solely by the four corners of the policy. Transocean argued that this argument “glosses over the inconvenient reality” that BP is an insured “only by virtue of the status conferred on it under the Drilling Contract.”
- Court noted that, since BP was not named anywhere in the insurance contract itself, it would have had no coverage at all under this analysis.
- The court found that the Transocean policies required that the additional-insured obligation arise from a contract involving an indemnity agreement and the policies specified that additional-insured coverage is extended as “obliged” and “where required” therein.
- Because Transocean did not assume liability for subsurface pollution in the drilling contract, Transocean was not “obliged” to name BP as an additional insured as to that risk. Because there is no obligation to provide insurance for that risk, BP lacks status as an “Insured” for the same.

- The court did not abandon *Atofina's* “separate and independent” test, but made clear that you must look to other documents outside of the policy if the policy directs you to in answering the additional insured analysis.
- Significantly, the court said that it would not look at limitations in transactional documents unless the policy directed that such an analysis be undertaken.

This new, revised *Atofina* test raises several questions:

- How direct must the policy language be in pointing to another document outside the policy when determining the existence of additional insured coverage?
- How clearly must the policy specify that a limitation in that other document may be incorporated into the policy for the provision to limit coverage?
- If BP had been named as an insured in an endorsement or insurance certificate, would it have precluded the Court from looking to the underlying contract?

Practice Pointers:

- The case reaffirms the importance of making sure the underlying contracts and related insurance policies are consistent, and requires care in drafting to make sure the parties get the intended result.
- The relationship between indemnity and the provision of insurance will have to be examined even more closely and the insurance policies will have to be examined more closely in terms of the provision of additional insured coverage.

Practice Pointers (cont'd):

- Significantly, BP was not issued a certificate of insurance naming it as an additional insured under the policy, but the court held that BP had additional insured status by examining the provisions of the insurance policies (Insured; Insured Contract).

- The court's focus on the existence of a certificate of insurance in the *Atofina* case, which was to be distinguished from the BP case, places greater emphasis on the acquisition of certificates of insurance by additional insureds.
- A certificate of insurance *may* avoid the need for a court to look at the underlying service agreement, where certain limitations on coverage may reside, as they did in the BP case.

Latest Developments: BP's Request for Rehearing

- April 22, 2015: BP filed motion for rehearing in Texas Supreme Court.
- Amicus Brief filed by National Association of Manufacturers in support of rehearing.
- No briefing yet filed by Transocean or its insurers, Ranger and Certain Underwriters at Lloyd's.

BP argues the Texas Supreme Court Got it Wrong Because *Deepwater Horizon*–

- 1. Departs from *Atofina*'s rule that the scope of coverage granted to an AI is determined from the terms of the policy itself.
- 2. “[E]levates certificates of insurance to unfounded significance.”
- 3. Reads additional language into the policy: The “obliged” and “where required” language in the Transocean policy is limited to “status”—who is an additional insured. It does not impose a substantive limitation on the scope of coverage (i.e. “obliged only to the extent” or “where required only to the extent.”)
- 4. Abandons the standard laid down in *Urrutia v. Decker* 992 S.W.2d 440 (Tex. 1999)

BP's Motion for Rehearing:

- Also argues--
 - The drilling contract at issue is governed by federal maritime law, not Texas law. The Court's interpretation of the contract exceeded its constitutional authority.
 - Court misinterpreted the Drilling Contract under federal maritime law.

Will the Court Withdraw Its Opinion and Rehear the Case?

Does the basic tenet of *Atofina* remain unchanged?

- You must look to the policy first to determine if there is coverage.
- If “the insurance policies include language that necessitates consulting” the underlying contract to determine additional insured status, then the Court must do so to make that determination.
- BP asserts that the Opinion “radically departs” from longstanding Texas law and that rehearing is necessary “to confirm whether Texas law has now overruled standards that have unwaveringly applied since the 1880s.” (footnote omitted).
- The Opinion stated: “We rely on the policy’s language in determining the extent to which, if any, we must look to an underlying service contract to ascertain the existence and scope of additional-insured coverage.”
- Probably does not change the significance of insurance certificate. Certificate is one factor in determining what steps are necessary with respect to determining AI status, but some uncertainty exists.

- Opinion asserts that it is consistent with *Urrutia*, while BP argues that the Opinion misinterprets *Urrutia*:
 - *Urrutia* says:
 - The underlying contract does not need to be attached to the policy to give effect to additional insured status.
 - Separate contract can be incorporated into an insurance policy by an “explicit reference clearly indicating the parties’ intention to include that contract as part of their agreement.”
 - Does the policy language at issue in *Deepwater Horizon*, which limits AI status to “where required” and as “obliged” by an oral or written contract, meet the test of being “an explicit reference clearly indicating the parties’ intention” to incorporate the Drilling Contract?
 - The dissent by Justice Johnson did not believe so, and BP, in seeking rehearing, argued that: “The Policies here contain no such words [“only to the extent” limiting language], and the difference is fundamental – and, under Texas law until now, dispositive.”

A “Principled” Approach To Insurance Coverage?

The American Law Institute’s Effort To Re-Define Insurance Law

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THE AMERICAN LAW INSTITUTE

“Dedicated to Clarifying and Improving the Law”

History Of This Restatement

- Begun in 2010 as a “Principles” project
- 2011-2013: Chapter 1 and 2 finalized
 - Policy Interpretation
 - Waiver and Estoppel
 - Misrepresentation
 - Duty to Defend
 - Duty to Settle
- October 2014: Changed to a Restatement

Restatements and Principles

- *Restatements* for the most part reflect a consensus statement of established law.
 - The law as it is.
 - Targeted to judges
- *Principles* reflects the law as the Reporters believe that it *ought* to be
 - Best practices, rather than established rules.
 - Targeted to legislators and regulators.

Structure of the Restatement

- Chapter 1: Basic Insurance Principles
- Chapter 2: Management of Defense
- Chapter 3: Scope of Coverage
- Chapter 4: Bad Faith

2013: Controversial Provisions

Policy Interpretation
Waiver and Estoppel
Misrepresentations
Consequences of Failing to Defend
Cumis Counsel
Resolving Fee Disputes
Right to Recoupment
Liability for Punitive Damages

2015: Controversial Provisions

Policy Interpretation

Consequences of Failing to Defend

Right to Recoupment

Liability for Punitive Damages

§3: Plain Meaning Presumption

- Courts are generally to be guided by the “plain meaning” of a policy term.
- Rule not absolute, however.
- Court may ignore plain meaning if “clearly” required by insured’s extrinsic evidence of drafting history or contracting intent.

How Is This Different?

- In most states, ambiguity can only be derived from the words of the policy and not from extrinsic evidence alone.
- Section 3 opens the door to discovery and reliance on drafting history and parole evidence.
- This may increase the cost and duration of coverage litigation by making it harder to obtain summary judgment.

§4: Resolving Ambiguities

- *Contra proferentem* will no longer serve as a “tie breaker.”
- Court should only rely on claimed ambiguity as a basis for finding coverage if all other tools fail to establish contracting intent of the parties.
- No exception for “sophisticated insureds”

Misrepresentations

- ALI analysis of misrepresentation issues in earlier drafts was extremely controversial
 - Insurers required to prove fraud
 - Negligent misrepresentations covered
 - Insurer bound to accept coverage but could charge premium retroactively.
- Controversial provisions have now all been deleted from new Discussion Draft.

Independent Counsel (§17)

- ALI adopts *Cumis* approach: conflict must be one affecting how case will be tried.
- Insured may consult with defense counsel to gain an understanding of whether insurer's RoR creates conflict of interest.

Failure to Defend (§21)

- Insurer that wrongfully refuses to defend will thereafter be estopped to contest its duty to indemnify judgment or settlement.
- This provision of Section 21 is probably the most controversial aspect of Chapter 2.
- Seems to be consistent with NC law
 - Bruce-Terminix Co. v. Zurich Ins. Co., 504 S.E.2d 574,580 (N.C. Ct. App. 1998)(insurer who wrongfully refuses to defend a suit against its insured is liable to the insured for the natural consequences of the breach, including sums expended in payment or settlement of the claim).

Control of Defense (§22)

- If multiple insurers have a duty to defend, insured may select who should defend.
- Designated insurer entitled to contribution from other carriers that owed defense.

Recoupment Claims

- No right to recoup costs of “courtesy defense” for non-covered suits (§24)
- No right to settle and then recoup costs of settling-non covered claims later (§31)

Damages For Breach of Insurer's Duty to Settle (§29)

- Failure to settle exposes insurer to full amount of judgment and other foreseeable damages.
- Consequential damages may include punitive damages even if not covered
 - Contrary to *PPG Industries, Inc. v. Transamerica Ins. Co.*, 975 P.2d 652 (Cal. 1999), and *Lira v. Shelter Insurance Co.*, 913 P.2d 514 (Colo. 1996).
- But probably not an issue in North Carolina since punitive damages are insurable unless due to malicious conduct on the part of the insured.
 - *Mazza v. Medical Mutual Ins. Co.*, 311 N.C. 621 (1984).

Settling Disputed Claims (§31)

- Insurer may not settle a claim and thereafter demand reimbursement of the settlement and not from the insured on the grounds that the claim was not covered.”
- Insured may settle without insurer’s assent but only if:
 - Insurer made aware of opportunity to settle
 - Insurer refused to withdraw RoR
 - A reasonable person would have settled
 - The demand is reasonably related to the amount of the loss that is covered.

Future of Chapters 1-2

- Preliminary Draft No. 1 was debated by Advisers and Members Consultative Group in Philadelphia on March 26-27, 2015.
- Ordinarily, draft would be reviewed by ALI council before being voted on by full membership.
- ALI announced this month that new draft would be submitted at ALI Annual Meeting in Washington on May 19, 2015 for “discussion” only.
- Move followed April 16 letter by general counsel of 8 insurance companies protesting hasty process.
- Will be voted on by ALI at May 2016 Meeting



Still To Come

- **Chap. 3: General Principles Regarding Risks Insured**
 - Trigger of Coverage
 - Allocation
 - Exclusions & Conditions
 - Exhaustion
- **Chap. 4: Advanced Contract Principles**
 - Remedies – ordinary and bad faith
 - Enforceability
 - Agent and broker liability
 - Choice of Law

Chapter 3

- Earlier drafts of Chapter 3 need to be revised to fit Restatement requirements.
- New text of Chapter 3 will be considered by ALI Advisers and MCG next Halloween at meetings in Philadelphia.
- Reporters hope to include final text of Chapter 3 (along with Chapters One and Two) for final approval at ALI Annual Meeting in May 2016.

Cases of Aggravated Fault (§37)

- Public policy is no basis for precluding coverage for consequences of intentional acts, including punitive damages.
- Insurers are free to adopt exclusions expressly eliminating coverage, however.

Breach of Policy Conditions (§42)

- Insured's failure to give timely notice or cooperate should not result in a disproportionate penalty.
- Requires substantial prejudice
- “Notice-prejudice” does not apply to “claims made” policies (so long as policy contains ERP provision).

Expected or Intended Exclusions

- §45: Whether injuries are “expected or intended” requires proof that the insured subjectively intended both the type and degree of injury that plaintiff suffered.
- §46: Exclusions only apply to insured that actually commits harm and not to “innocent” insureds.

Excess Insurers (§51)

- Excess insurer's duties do not arise until underlying limits are exhausted.
- Underlying exhaustion does not require actual payment of policy limits so long as insured's liabilities exceed retention amount (the *Zeig* rule).
- Insolvency of primary policy does not generally require excess insurer to “drop down.”

Long-Tail Issues

- Preliminary drafts circulated before October 2014 proposed “all sums” for allocation and broad rights of exhaustion for insurers (vertical and horizontal).
- Withdrawn from current drafts.
- Uncertain future.

Why You Should Care?

- ALI Restatements are not statutes
 - They don't have the force of law.
- Insurance law is not static.
- These provisions may be very influential in states where the law is not well developed on insurance coverage issues.

You Can Be Influential

- Even if you aren't a member of ALI, you can have an impact of this Restatement.
- Go on ALI.org. Find people you know who are Advisers or on the MCG.
- Give them construction, concrete examples of cases to guide Reporters.
- People who don't act, don't get to complain.



THE AMERICAN LAW INSTITUTE

The Principles Of The Law Of Liability Insurance

Questions?

ACCEC Annual Meeting 2015

Chicago, Illinois

Reservations, Please: Recognizing and Attending to Conflicts

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Overview

- Put aside our adversarial hats
- Focus on best resolution and solutions
 - Good for business
 - Respect for rights of all parties

Is there a benchmark standard?

- Recognize professional responsibility obligations of defense lawyers
- Protect insurers' defenses
- Acknowledge policyholders' rights to adequate defense
- Eliminate unnecessary disputes

Recognizing Conflicts of Interest

- Is there a Conflict?
- When Does it Arise?

Pre-Suit Considerations

- Reservation of rights-general
- Decisions for insurer
 - Appoint counsel or advise of conflict
 - Statutory notice period
- Decisions for policyholder

Factual Situations

- **Select Comfort Corp. v. Arrowood**
(N.D. Minn. 2015)
- **Twin City Fire Ins. Co. v. City of Madison, Mississippi**, 309 F. 3d 901
(5th Cir. 2002) (applying Ms law)
- **Specialty Surplus Ins. Co. v. Second Chance, Inc.**, 2006 WL 2459092 *(W.D. Wash. 2006)*

Post-Suit Considerations

- Potential conflicts arising out of judicial concern that insurer might prejudice insured:
 - (1) insurer may defend case in such a way as to defeat coverage;
 - (2) insurer may mount less than vigorous defense;
 - (3) insurer may obtain confidential information to use against insured in coverage dispute

Valid reasons for appointing independent counsel

- Avoid coverage by estoppel
- Put burden on independent counsel to protect confidences
- Protect defense lawyer from being compromised
- Eliminate insurer's risk for excess liability based on defense lawyer conduct

Independent Counsel

- Potential Abuses

Importance of access to and use of information relating to defense and coverage

- Decision-maker at insurance company with access to both liability and coverage information, including privileged information from the insured
- Who provides the information?
- Who protects the information?

Valid reasons for Splitting the Claims File: Reasonable precaution

- Avoid allegations of bad faith or coverage by estoppel
- Avoid alleged appearance of impropriety
- Provide extra assurance to policyholder of fair treatment, avoidance of prejudice to insured
- Increase defense lawyer's willingness to share information crucial to the defense of the case
- Enhance ability to assert attorney-client privilege or work product regarding coverage related communications
- May obviate need for independent counsel, if no conflict

Promote settlements where conflicts exist

- Who has the checkbook: coverage or liability adjuster?
- Liability adjuster evaluate exposure and settlement value without regard to coverage issues
- Liability adjuster monitor communications with Plaintiff
- Independent counsel should provide policyholder's demand for authority to settle and support for request in light of risk
- Coverage adjuster provide settlement authority based on defense lawyer's demand and liability adjuster's evaluation
- Coverage adjuster should raise any coverage issues that might support contribution by policyholder to independent counsel or policyholder coverage counsel

Coverage adjuster and policyholder counsel need to openly address issues and options

- Settle subject to insurer reservation to recoup or policyholder objection
- Settle with mutual reservation of rights
- Settle with contribution from each and no recoupment
- Insurer settle without reservation of rights
- No settlement

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- Edward “Ned” Currie, Jr.; Joseph W. Gill; John G. Farnan, Laura “Megan” Faust, “*Handling Liability and Coverage Claims: Splitting Files, the Duty to Defend, and Ethical Considerations for Lawyers*,” FDCC Quarterly/Fall 2011 at p. 51.

A PRACTICAL GUIDE THROUGH THE ETHICAL WEB OF THE TRIPARTITE RELATIONSHIP

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A PRACTICAL GUIDE THROUGH THE ETHICAL WEB OF THE TRIPARTITE RELATIONSHIP

by Jill B. Berkeley

At the start of litigation against a policyholder and a tender of the defense to the insurer, the insurer generally reviews the policy and the underlying complaint and determines if any conflict exists. If the insurer asserts a coverage defense, it should address whether its interests in defending the policyholder will be or are potentially adverse to the interests of the insured. Nevertheless, it is defense counsel hired by the insurer to represent the insured who, acting as counsel for both the insurer and the insured throughout the litigation, is the gatekeeper of the ethical obligations and duties owed to each client. Ultimately, it is defense counsel who must determine whether the interests of the insurer will be or are potentially adverse to the interests of the insured. This is the ethical burden defense counsel must bear in order to represent the interests of both the insurer and the insured, or in any multiple client situation. This relationship among the defense counsel, the insured, and the insurer is known as the tripartite relationship. It is the purpose of this article to analyze the web of ethical dilemmas defense counsel face and to discuss the appropriate strategies to avoid entanglement within the tripartite relationship.

DUTY TO DEFEND

As a primer on this subject, a brief overview of an insurer's defense obligations under a general liability policy is necessary. Standard form general liability policies provide a defense to the insured for claims asserted against it by third parties. Under Illinois law, when an insured tenders its defense to the insurer, the insurer must

provide a defense as long as there is a *potential* that the allegations in the complaint asserted against the insured would be covered by the policy at issue.¹ The duty to defend may not justifiably be refused by the insurer “unless it is clear from the face of the underlying complaint that the allegations set forth in that complaint fail to state facts that bring the case within or potentially within the insured’s policy coverage.”² Once the duty to defend arises, the insurer generally has the right under the insurance policy to, among other things, select defense counsel and control the defense.

WHO IS THE CLIENT?

Who is defense counsel’s client: the insurer, the insured, or both? This question depends on what jurisdiction governs defense counsel’s practice. In Montana, for example, defense counsel only has one client, the insured, not the insurer.³ In jurisdictions such as Montana, defense counsel need not be concerned with potential conflicts of interest between the insurer and the insured, since defense counsel has only one client.

In jurisdictions such as Illinois, defense counsel retained by the insurer to represent the insured has two clients, the insurer and the insured.⁴ It is in these two-client jurisdictions where defense counsel must be aware of obligations to each client. As to both clients, defense counsel has a duty to ascertain if there is any conflict of

¹ *Outboard Marine v. Liberty Mut. Ins. Co.*, 154 Ill.2d 90, 125, 607 N.E.2d 1204, 1220 (1993).

² *Gen. Agents Ins. Co. of America v. Midwest Sporting Goods Co.*, 215 Ill.2d 146, 154-55, 828 N.E.2d 1092, 1098 (2005).

³ *In the Matter of the Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedures*, 229 Mont. 321, 2 P.3d 806 (Mont. 2000).

⁴ *Waste Management v. International Surplus Lines Ins. Co.*, 144 Ill.2d 178, 194, 579 N.E.2d 322, 329 (1991).

interest, such as if the insurer's objectives are adverse to the insured (or vice versa),⁵ to advise *both* of the conflict to determine if the conflict could be waived and to seek a waiver of the conflict and consent to represent both.

When defense counsel is confronted with a situation where the interests of the insurer and the insured are in conflict, Illinois Rules of Professional Conduct provide guidance. Rule 1.7(b) states, “[a] lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer’s responsibilities to another client or to a third person, or by the lawyer’s own interests, unless: (1) the lawyer reasonably believes the representation will not be adversely affected; and (2) the client consents after disclosure.” To this end, defense counsel cannot represent both the insured and the insurer if counsel’s responsibilities to one client will be materially limited by its responsibilities to the other.

However, under Rule 1.7, defense counsel may continue its representation of both clients (1) if counsel reasonably believes that it can represent both the insurer and the insured; (2) if counsel limits its representation to the insured to the extent the interest of the insurer are in conflict (by perhaps pursuing a litigation strategy more akin to the insurer’s objectives); and (3) if counsel gets consent after full disclosure from both clients as to its representational limitations. Only after these steps are taken may defense counsel continue to represent both clients.

Furthermore, while defense counsel’s scope of representation is limited to the defense of the insured against potential liability, defense counsel has an ethical duty to both clients to recognize conflicts of interest and weigh the insurance consequences of

⁵ Rule 1.7(a) and (b).

certain litigation strategies. Specifically, issues that defense counsel should be aware of that may have coverage implications are: whether there is other insurance; whether the self-insured retention has been satisfied; whether there are additional insured issues; whether there are (or will be) allocation issues; what damages will be covered or not; and whether the insured has potential liability in excess of policy limits. The potential impact of these issues must be considered, not only for the benefit of the insured, but also for the benefit of the insurer, because defense counsel may unintentionally create an adverse condition for one of his clients. Importantly, defense counsel may need to seek advice from its own counsel as to its ethical obligations so as not to inadvertently prejudice either client.

Besides the mutual duties owed to each client, defense counsel also has specific obligations to exercise independent professional judgment. Per the insuring agreement, the insurer is entitled to control the defense of the insured. However, the insurer's contractual right to control the defense under the policy neither obligates nor permits defense counsel to disregard its duty to exercise professional judgment regarding the defense of the insured. As stated in Illinois Rule of Professional Conduct 5.4(c), "a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services." Defense counsel cannot allow the insurer to control the defense, where doing so would infringe on the professional judgment of counsel in its defense of the insured.⁶

⁶ The insurer is entitled to control the defense because the insured per the insuring agreement, has waived and consented to its right to control the defense. However, when settlement opportunities arise, defense counsel cannot act under the sole direction of the insurer; instead, both insurer and insured must be consulted. See Rule of Prof. Resp. 1.2(a) (requiring counsel to "abide by a client's

However, because the insured is also a client, defense counsel owes the insured specific duties as well. For one thing, per Illinois Rules of Professional Conduct 1.4(a) defense counsel must keep the policyholder “reasonably informed” about the status of the underlying action. Although the policyholder waived its right to control the defense per the insuring agreement, the policyholder is still entitled to be apprised of significant information regarding its defense. With this information, the policyholder can determine if it needs to hire outside counsel or whether settlement should be pursued.

CONFLICT OF INTEREST

Although the law allows defense counsel to limit its representation of the insured to the issues of liability and damages, this does not mean counsel can act adverse to the interests of the insured for the benefit of the insurer’s interests. In fact, the Illinois Supreme Court, in the *Maryland Casualty Company v. Peppers (Peppers)* opinion has made clear that defense counsel may not advance positions against the interests of the insured.⁷ In *Peppers* the underlying plaintiff was injured when shot with a firearm by the insured.⁸ The insured sought coverage from its insurer under its general liability policy.⁹ Responding to this tender, the insurer sought a declaration that the underlying action was not covered by the policy because the intentional harming of another is excluded by the policy.¹⁰ However, the *Peppers* court determined that the insurer did have, at least,

decision whether to accept an offer of settlement”); ABA Formal Ethics Opinions 96-403, *Obligations of a Lawyer Representing on Insured Who Objects to a Proposed Settlement Within Policy Limits* (August 2, 1996) (explains that “[i]f a lawyer for an insured knows that the insured objects to a settlement, the lawyer may not settle the claim against the insured at the direction of the insurer, without giving the insured an opportunity to reject the defense offered by the insurer and to assume responsibility for his own defense at his own expense”).

⁷ *Maryland Casualty Company v. Peppers*, 64 Ill.2d, 187, 355 N.E.2d 24 (1976).

⁸ *Id.* at 191-92.

⁹ *Id.* at 192.

¹⁰ *Id.* at 191.

a defense obligation because the underlying allegations contained claims of negligent conduct (which would be covered by the policy), even though there were also claims of intentional conduct (which would be excluded by the policy).¹¹ As such, under Illinois duty to defend jurisprudence, because the insured could potentially be liable for the alleged conduct, the insurer was found to have a defense obligation.

Because the insurer had a defense obligation, the *Peppers* court reasoned that a conflict of interest existed for defense counsel representing both the insurer and the insured.¹² As the court explained:

In the personal injury action, if Peppers is held responsible, it would be to his interest to be found negligent, which under the policy of insurance, would place the financial loss on [the insurer]. On the other hand it would be to [the insurer's] interest to have a determination that Peppers intentionally injured [the underlying plaintiff], which, by the terms of the policy, would relieve [the insurer] of the obligation to pay the judgment.¹³

Thus, the *Peppers'* court found that defense counsel cannot adequately represent both the objectives of the insurer (whose interest is to deny coverage based on a theory of intentional conduct) and the objectives of the insured (whose interest is to be found not liable or, at minimum, negligent so as to be covered by the policy).¹⁴ These divergent objectives of the insurer and the insured require defense counsel to take adverse positions against both of its clients. It is because defense counsel may not take adverse positions against its clients that simultaneous representation of both the insured and the insurer is prohibited. As such, defense counsel was required to withdraw and the insured in *Peppers* was entitled to independent counsel paid for by the

¹¹ *Id.* at 193.

¹² *Id.* at 198.

¹³ *Id.* at 197.

¹⁴ *Id.* at 198.

insurer.¹⁵

When a conflict of interest does arise, defense counsel must know how to advise the insured regarding its limited representation and the scope of engagement. The easiest way to properly advise the insured as to the limited representation in face of a conflict is to send an engagement letter to the insured outlining all conflicts and potential conflicts. The engagement letter should be similar to a proper reservation of rights letter generally sent by the insurer advising the insured of enough facts so that an informed decision can be made between consenting to the conflict and the limited representation or seeking independent counsel.

CONFIDENTIAL COMMUNICATIONS

Outside of the clear ethical conflicts that arise in the *Peppers'* situations, defense counsel also needs to be aware of *other* ethical conflicts that arise in a more benign setting. For example, what are the ethical obligations of defense counsel to protect confidential information disclosed by the insured regarding whether coverage exists?

Illinois Rule of Professional Conduct 1.6(a) states, “[a] lawyer shall not, during or after termination of the professional relationship with the client, use or reveal a confidence or secret of the client known to the lawyer unless the client consents after disclosure.” Accordingly, if the insured discloses in confidence information as to whether the underlying action would be covered by the policy, it would be a violation of defense counsel’s ethical duties to disclose such information to the insurer.¹⁶ However,

¹⁵ *Id.* at 198-99.

¹⁶ See also ABA Standing Committee on Ethics & Professional Responsibility, Formal Op. 01-421 (explaining that “if a lawyer reasonably believes that disclosure of the insured’s confidential information to the insurer will affect a material interest of the insured adversely, the lawyer must not disclose such information without the consent of the insured”).

defense counsel also represents the insurer, and Illinois Rule of Professional Conduct 1.4 requires defense counsel to keep the insurer “reasonably informed about the status of a matter.” In that regard, from the standpoint of the insurer, communications between defense counsel and the insured concerning coverage must be disclosed because the status of the matter includes defense counsel’s knowledge of any facts relating to the claims against the insured, regardless of whether these facts impact coverage. So, what should defense counsel do if privileged communications regarding coverage are disclosed to defense counsel by the insured? Defense counsel caught in this precise ethical dilemma has three alternatives:

- *First*, defense counsel can try to seek the insured’s consent to disclose the information to the insurer. If the insured consents after full disclosure, the ethical issue is resolved.
- *Second*, if the insured will not consent to disclosure, then defense counsel needs to determine whether “consent to withhold the information to the insurer can be obtained without violating the insured’s right to confidentiality.” If the insurer does not consent, then defense counsel must withdraw.
- *Third*, if defense counsel cannot make the request for consent to the insurer “because to do so would violate the right to confidentiality [of the insured], then defense counsel must advise the insured to retain separate coverage counsel to protect the insured’s rights The defense counsel must maintain the insured’s request for secrecy, but cannot continue in the tripartite relationship.”¹⁷

¹⁷ Jill B. Berkeley, “Tripartite Ethics: Confidential Communications among the Insured, the Insurer, and Defense Counsel,” *The Brief*, Spring 1997, at 24.

If defense counsel fails to obtain consent, the only option is for defense counsel to withdraw without disclosing the information.

DISCOVERY OF INFORMATION AFFECTING COVERAGE

Another issue that may create a conflict of interest is if the facts at issue in the underlying suit will affect a determination of coverage. This was the issue recently presented to the Second District in *American Family Mutual Insurance Company v. W.H. McNaughton Builders, Inc. (McNaughton)*.¹⁸ The plaintiffs in the underlying case, the Begys, sued their homebuilder, McNaughton, alleging that their home suffered from mold damage.¹⁹ McNaughton tendered its defense to its insurer under its general liability policy.²⁰ The insurer agreed to defend McNaughton but under “a complete reservation of rights to later deny coverage.”²¹ In particular, the insurer contended that the policy did not cover McNaughton for property damage occurring before the inception of the policy.²² Responding to the reservation of rights, McNaughton argued that a conflict of interest existed for defense counsel, as facts that would be discovered in the underlying case could support a bar of coverage.²³

The Second District agreed and held that there was a conflict of interest for defense counsel, as the interests of McNaughton and the insurer were divergent:

A conflict already exists here. A conflict does not arise at the time a lack of coverage is unequivocally established. A conflict arises when the divergent interests of the insurer and insured are apparent and the attorney representing the insured can no longer represent both clients’

¹⁸ *American Family Mutual Insurance Company v. W.H. McNaughton Builders, Inc.*, 363 Ill. App. 3d 505, 843 N.E.2d 492 (2nd Dist. 2006).

¹⁹ *Id.* at 507.

²⁰ *Id.* at 507-08.

²¹ *Id.* at 508.

²² *Id.*

²³ *Id.*

interests without prejudice to either client. A conflict already exists here because [the insurer's] interests would be served by fleshing out in discovery facts showing that the damage to the Begys' home occurred prior to the inception of the Policy, while McNaughton's interests would be served by fleshing out facts showing that the damage occurred after the inception of the Policy. In this regard, an attorney representing [the insurer's] interests would be the enemy of McNaughton.²⁴

As such, McNaughton was entitled to independent counsel.²⁵

McNaughton clarifies that defense counsel representing both the insurer and insured can have an ethical conflict based upon the development of facts in the underlying case. Once the insurer reserves its rights to deny coverage on a fact issue to be determined in the underlying case, then a conflict exists for defense counsel because that will be an issue litigated in the underlying case. Although some would argue that *McNaughton* represents new law within the conflict of interest jurisprudence, other cases have addressed similar issues finding that a conflict was present based upon the facts of the underlying complaint. See *Doe v. Illinois State Medical Inter-Insurance Exchange*, 234 Ill. App. 3d 129, 599 N.E.2d 983 (1st Dist. 1992) (conflict of interest existed because the alleged conduct may have occurred within multiple policy periods); *Pepper Const. Co. v. Casualty Ins. Co.*, 145 Ill. App. 3d 516, 495 N.E.2d 1183 (1st Dist. 1986) (conflict of interest existed because fact issues as to the insureds vicarious liability needed to be adjudicated in the underlying case in order determine whether the insured's liability came within the policy's coverage); see *Mitchell v. Tatum*, 104 Ill. App. 3d 986, 433 N.E.2d 978 (1st Dist. 1992) (conflict of interest existed because the insurer asserted a late notice defense after a default judgment was entered); *Burlington Northern R. Co. v. Illinois Emcasco Ins. Co.*, 158 Ill. App. 3d 783,

²⁴ *Id.* at 514.

²⁵ *Id.* at 515.

511 N.E.2d 776 (1st Dist. 1987) (conflict of interest existed because some of underlying allegations would be covered by the policy, whereas other allegations would not be); *Louis Marsch Inc. v. Pekin Ins. Co.*, 140 Ill. App. 3d 1079, 491 N.E.2d 432 (1st Dist. 1986) (potential conflict of interest existed because the allegations of the underlying complaint seek to hold the insured liable for both claims which are barred by the automobile exclusion and for non-auto related claims which arise from negligent acts of the insured which would be covered); *Maneikis v. St. Paul Ins. Co. of Illinois*, 655 F.2d 818 (7th Cir. 1981) (potential conflict of interest existed because although allegations alleging fraud would be excluded from coverage, the malpractice allegations are covered by the policy); *Gibraltar Cas. Co. v. Sargent & Lundy*, 214 Ill. App. 3d 768, 574 N.E.2d 664 (1st Dist. 1991) (conflict of interest existed because allegations regarding failure to design an atomic power plant and fraudulent efforts to cover up deficiencies are both covered and non-covered claims); *Harbor Ins. Co. v. Tishman Const. Co.*, 218 Ill. App. 3d 936, 578 N.E.2d 1197 (1st Dist. 1991) (potential conflict of interest existed because whether damages in underlying claim regarding defective design in the construction of a parking garage fell within exclusionary clause was a fact question yet to be adjudicated in the underlying suit). Thus, it is clear that *McNaughton* reiterates the lineage of cases that followed *Peppers* which hold that a conflict of interest exists for defense counsel whenever the interest of the insurer become the enemy of the insured.

DISCLOSING THE CONFLICT

In *Utica Mutual Ins. Co. v. David Agency Ins.*, 327 F. Supp. 922 (N.D. Ill. 2004) (*Utica Mutual*), the court outlined the necessary information that should be in a reservation of rights letter. In *Utica Mutual* the underlying plaintiff sued David Agency

Insurance (“David”) for, among other things, defamatory statements and sought \$500,000 in compensatory damages and \$500,000 in punitive damages.²⁶ David tendered its defense to its insurer. The insurer retained counsel for David but did so under a full reservation of rights.²⁷ Specifically, the insurer contended that certain policy exclusions “may” bar coverage and that David may, at its own expense, “hire a personal attorney to protect [it] for the punitive damages or any uncovered portions of the policy.”²⁸ Eventually judgment in the underlying action was entered against David which included both compensatory and punitive damages.²⁹ Thereafter the insurer sought a declaration that it was not obligated to indemnify David for the judgment entered against it.³⁰

The court disagreed with the insurer. In a methodical opinion the court went through the conflict of interest analysis. First, the court held that the potential liability asserted against David in the underlying complaint, specifically the defamation claim, was broad enough to be covered by the policy.³¹ Accordingly, the insurer had a defense obligation.³² Second, the court found that a conflict of interest did exist for defense counsel as the insurer’s “interests would be furthered if David were shown to intentionally defamed . . . where David’s interest, short of winning the case, was to show it acted only negligently.”³³ Thus, the court held that in these conflict situations, David

²⁶ *Id.* at 925.

²⁷ *Id.*

²⁸ *Id.* at 926.

²⁹ *Id.* at 925.

³⁰ *Id.*

³¹ *Id.* at 927.

³² *Id.*

³³ *Id.* at 929.

would be entitled to independent counsel paid for by the insurer.³⁴ Finally, the court explained, that if a conflict does exist, and the insurer chooses to defend the insured, it must do so under a proper reservation of rights “or risk being estopped from raising coverage defenses.”³⁵ The court explained that a “proper reservation of rights is one that allows the insured to choose intelligently between accepting the insurer’s defense counsel and retaining his own counsel.”³⁶ The court continued:

If the insurer proceeds to defend the insured in face of a conflict of interest, it must reserve its rights in a manner that will *fairly* inform the insured of the insurer’s position. In informing the insured of the conflict, the insurer must act openly and with the utmost loyalty to its insured both in initially explaining the insurer’s position in the matter and in the actual defense of the tort litigation. Bare notice of a reservation of rights is insufficient unless it makes specific reference to the policy defense which may ultimately be asserted *and* to the potential conflict of interest.³⁷

The court in *Utica Mutual* found that the insurer’s reservation of rights letter did not “adequately disclose the conflict of interest.”³⁸ Indeed, the court found that the insurers “bare notice that intentional actions and punitive damages were not covered by the policy . . . did nothing to inform David of the conflict of interest related to the defense of the case, particularly as to the defamation claim.”³⁹ Moreover, the court found that the insurer’s statement that “David may, at [its] own expense hire a personal attorney to protect against uncovered losses likewise failed to satisfy the requirements for a proper reservation of rights.”⁴⁰ Lastly, the court had “concerns” about the insurer’s failure to inform David “about the prior and long-standing relationship between [the insurer] and

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 930.

³⁷ *Id.* (internal quotations and citations removed, emphasis in original).

³⁸ *Id.* at 931.

³⁹ *Id.*

⁴⁰ *Id.*

the law firm it chose.⁴¹ Accordingly, the court found that due to the deficient reservation of rights letter, the insurer was estopped from raising coverage defenses regarding the judgment entered against David.⁴²

The *Utica Mutual* court agreed, as one commentator explained, that an insurer should include in its reservation of rights the following disclosures:

- (1) the attorney's relationship to the insurer;
- (2) the attorney's own interests;
- (3) the nature of the conflict between the insurer and the insured and how the defense may impact the coverage;
- (4) limitation of the scope of representation to defending third-party claim only, thus limiting the ability to maximize coverage;
- (5) the insured's option to retain separate counsel to advise about coverage issues; and
- (6) the insured's right to independent counsel to defend, whose fees will be reimbursed by the insurance company.⁴³

The purpose of these disclosures, just as explained in *Utica Mutual*, is twofold: (1) to inform the insured of the present and potential conflicts of interest; and (2) to allow the insured to make an informed decision as to whether to waive the conflicts and allow defense counsel retained by the insurer to continue its representation, albeit a more limited one.

Although the Anderson article and the *Utica Mutual* opinion focus on the reservation of rights letters the insurer sends to the insured, defense counsel has its own obligation to disclose to the insured if a conflict of interest exists. Defense counsel must disclose enough information to the insured in order to adequately explain the ramifications of a conflict to the insured. For example, defense counsel must disclose present and potential conflicts, its relationship with the insurer, limitations on the scope

⁴¹ *Id.*

⁴² *Id.*

⁴³ David H. Anderson, "Balancing the Tripartite Relationship between Defendant, Defense Counsel, and Insurer," 88 *Illinois Bar Journal* 384, 388 (July 2000).

of representation, and the right to independent counsel.

Moreover, defense counsel should not solely rely on the insurer to make the appropriate disclosures in order to satisfy defense counsel's ethical obligations to both clients. Nor should defense counsel stand idle if the insurer makes inadequate disclosures as that may lead to an estoppel issue for the insurer or an ethical violation for defense counsel. Instead, in order to comport with defense counsel's own ethical obligations, defense counsel should independently advise the insured of all the present and potential conflicts. The insured must be able to make an informed decision regarding waiving defense counsel's conflict and accepting a limited representation.

INDEPENDENT COUNSEL

If, after full disclosure of conflicts, the insured will not waive the conflict, the insured has the right to independent counsel paid for by the insurer.⁴⁴ As independent counsel, the question then arises: what duties are owed to the insured and insurer? Independent counsel now has an unlimited scope of engagement to defend and to maximize coverage for the insured. Independent counsel represents the interests of the insured, not the insurer. Nevertheless, the insured has an obligation to cooperate with the insurer. Independent counsel must be aware of the obligation to report significant developments on liability and damages. Independent counsel also has to provide enough information to the insurer so it will reimburse the defense costs as incurred. Accordingly, in order protect the insured from breach of the duty to cooperate, independent counsel should provide, on behalf of the insured, relevant information to the insurer regarding the defense. But, independent counsel should not disclose

⁴⁴ *Peppers*, 64 Ill.2d at 198-99.

confidential communications or information which adversely affects coverage to the insurer as that would be a breach of the duty of loyalty to the insured.

The insurer may try to impose litigation guidelines on independent counsel that affect her professional judgment. These guidelines tend to be restrictive and require counsel to seek approval from the insurer as to what costs will be covered. Independent counsel has no obligation to abide by these guidelines. And, unlike panel defense counsel, independent counsel has no contractual relationship with the insurer. Second, independent counsel should resist any guidelines if they infringe on her independent professional judgment. In practice the guidelines can control the substance of the litigation by controlling what may be spent. The insurer, through the guidelines, can limit what costs should be expended to further the defense for the insured. The Restatement (Third) of Law Governing Law § 134(2)(b) (2000), states that the “lawyer’s professional conduct on behalf of a client may [not] be directed by someone other than the client if the direction . . . interfere[s] with the lawyer’s independence of professional judgment.” As stated earlier, independent counsel’s objectives should be to vigorously represent the interests of the insured and to seek to maximize insurance coverage.⁴⁵ When the insurer seeks to control independent counsel through the use of litigation guidelines, the insurer is interfering with the autonomy and the professional judgment of independent counsel in advancing the objectives of the insured.

With that said, independent counsel may wish to implement those guidelines that will maximize insurer reimbursement of the attorney’s fees incurred by independent

⁴⁵ *Transport Ins. Co., Inc. v. Post Exp. Co., Inc.*, 138 F.3d 1189, 1193 (7th Cir. 1998) (explaining that upon retaining independent counsel “there is little need to protect the insured from the carrier, and a potential need to protect the carrier from the insured”).

counsel, where the guidelines do not impose on the professional judgment of independent counsel. For example, if the guidelines require billing in increments of tenths, rather than quarters of an hour, independent counsel should acquiesce. Billing in tenths rather than quarters of an hour, does not impose on the professional judgment of independent counsel, and may in fact help facilitate maximizing reimbursement.

The insurer may also try to impose on independent counsel the use of preset litigation rates. Independent counsel's rates should be based on what is "reasonable" and not on some preset rate the insurer customarily pays its panel defense counsel.⁴⁶ In determining a reasonable rate, Illinois Rule of Professional Conduct 1.5(a) sets out the following factors to be considered:

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

The factors demonstrate that independent counsel's rates cannot be preset by the insurer prior to determining the complexity of the case and the scope of the litigation. In fact, what these factors suggest is that what may be a reasonable fee in the beginning of the litigation may change pending upon the direction of the litigation. As such, independent counsel, the insurer, the insured, and potentially the court should use these factors to determine independent counsel's reasonable rate, without resort to

⁴⁶ *Mobil Oil Corp. v. Maryland Cas. Co.*, 288 Ill. App. 3d 743, 681 N.E.2d 552 (1st Dist. 1997) (determining reasonableness based on similar factors as Illinois Rule of Professional Conduct 1.5(a)).

insurer's preset rates.

Unlike insurer-retained defense counsel, who has two clients, independent counsel's objectives are more straightforward. Like panel defense counsel, independent counsel is to defend the insured against potential liability. However, unlike insurer-retained defense counsel, independent counsel shall also pursue litigation strategies in the underlying action, which will maximize insurance recovery, potentially be adverse to the insurer for the benefit of the insured (when required), and always put the insured's interests above the insurer.

CONCLUSION

Because defense counsel owes its own ethical obligations and duties to both clients, defense counsel needs to know how to spot a conflict of interest, how to deal with it, and when it's time to withdraw. Likewise, independent counsel must understand that its objectives are different from that of panel defense counsel. Independent counsel must not only defend the insured, but more importantly seek to maximize insurance recovery. With these goals in mind, both defense counsel and independent counsel can be better prepared to handle the ethical web of the tripartite relationship.

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**WHEN CLAIMS AND COVERAGE COLLIDE:
DEFENDING THE INSURED UNDER A RESERVATION OF RIGHTS
AND HANDLING CONFLICTS OF INTEREST**

PAPER BY:

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A. What Conflicts of Interests Arise When An Insurer Defends Its Insured Under A Reservation Of Rights?

It is a basic principle of law – liability insurance companies owe a duty to defend and investigate any potentially covered claim against an insured. However, the obligations of the insurer pre-suit can be different than post-suit obligations. Pre-suit, generally, there is no collision between coverage and defense interests. If there is no immediate or apparent conflict, an adjuster can investigate coverage and liability while reserving its rights. At this initial stage, the adjuster can accept or deny the claims.

It is when suit is filed that the collision can occur. Liability insurance companies generally have an absolute duty to defend their insureds against claims where it is clear that the claims are covered under the language of the policy. Likewise, liability carriers have no duty to defend against claims that are clearly outside the coverage afforded under the insured's policy. However, when coverage is less than clear, such as “where the allegations of the complaint are covered by the liability policy, but the facts are such that it may very well develop at trial that the conduct of the insured was not covered by the policy” or where “the allegations of the complaint themselves are ambiguous so that read in one way there is no coverage, but read in another there is,” “[u]nquestionably, the insurance carrier has a right to offer the insured a defense, while at the same time reserving the right to deny coverage in even a judgment is rendered against the insured.” *Moeller v. Am. Guar. & Liab. Ins. Co.*, 707 So. 2d 1062, 1069 (Miss. 1996).

In such cases, *i.e.*, where the carrier defends its insured under a reservation of rights, various conflicts of interest may arise between the insurer and its insured. Specifically, courts have identified three potential conflicts which frequently may arise in this context:

(1) the insurer may steer the defense so as to make the likelihood of a plaintiff's verdict greater under an uninsured theory; (2) the insurer may offer a less than vigorous defense if the insurer knows that it can later assert non-coverage, or if it thinks that the loss it is defending will not be covered under the policy; and (3) the insurer might gain access to confidential or privileged information, which it might later use to its advantage in litigation concerning coverage.

Armstrong Cleaners, Inc. v. Erie Ins. Exch., 364 F. Supp. 2d 797, 814-15 (S.D. Ind. 2005) (citing *CHI of Alaska, Inc. v. Employers Reinsurance Corp.*, 844 P.2d 1113, 1116, 1118 (Alaska 1993)).

With respect to the first type of conflict, *i.e.*, that the insurer may direct the defense such that the plaintiff's verdict is greater under an uninsured theory, the Court in *Continental Insurance Company v. Bayless & Roberts, Inc.*, 608 P.2d 281, 289-90 (Alaska 1980), stated:

[This] conflict arises when success on a particular theory of recovery in the case against the insured would result in the denial of coverage under the policy. In that case, the insurance company would have an interest in seeing the plaintiff obtain a verdict based on the theory under which no coverage would result. For example, if a plaintiff alleged both negligence and an intentional tort as alternative theories of recovery, an insurer operating under a reservation of

rights might covertly frame its defense to achieve a verdict based upon commission of the intentional tort, so that it could later assert that the defendant was not covered, since the policy provided no coverage for intentional torts. In the absence of a reservation of rights agreement, however, the insurer would be liable for indemnification regardless of whether the verdict established negligence or an intentional tort, and thus would be more likely to defend vigorously on both grounds.

(Internal citation omitted).

With respect to the second type of conflict which may arise, *i.e.*, that the insurer may offer a less than vigorous defense, knowing it can subsequently assert non-coverage, or believing that the loss will not be covered under the policy, the Court in *Continental* noted as follows:

[I]f the insurer knows it can later assert non-coverage . . . it may offer only a token defense of its insured. If the insurer does not think that the loss on which it is defending will be covered under the policy, it may not be motivated to achieve the lowest possible settlement or in other ways treat the interests of its insured as its own.

Id.

With respect to the third type of conflict, *i.e.*, that the insurer may obtain confidential or privileged information through the course of the defense which it may use to its advantage in a later coverage action, the Court in *Continental* stated the following:

Even if the insurer vigorously and properly defended the claim against its insured, it could still take actions which could prejudice the insured's position in a later suit on the policy. If nothing else, the insurer might gain access to information, not otherwise properly available to it, which it could use to its advantage later to establish the insured's breach.

Id. at 291.

If these conflicts of interest are not handled properly by the insurer, the result may be estoppel from denying liability coverage or even liability for bad faith claim handling. *See Twin City Fire Ins. Co. v. City of Madison, Miss.*, 309 F.3d 901, 907-09 (5th Cir. 2002) (Miss.). The remainder of this paper addresses ways in which both insurers and defense attorneys can handle such conflicts of insurance so as to avoid such consequences.

B. How Can Insurers Handle Conflicts of Interests Which Arise When Defending The Insured Under A Reservation of Rights?

1. Hiring Independent Counsel For The Insured

In *Moeller v. American Guaranty and Liability Insurance Company*, 707 So. 2d 1062, 1069 (Miss. 1996), the seminal Mississippi case on this issue, the Mississippi Supreme Court stated as follows:

When defending under a reservation of rights, however, a special obligation is placed upon the insurance carrier. While this Court has not been called upon to address this issue, other jurisdictions have generally held that in such a situation, not only must the insured be given the opportunity to select his own counsel to defend the claim, the carrier must also pay the legal fees reasonably incurred in the defense.

(Internal citations omitted). Since *Moeller*, Mississippi courts generally hold that an insurance company defending an insured under a reservation of rights must provide the insured “ample opportunity to select his [the insured’s] own independent counsel.” *Id.* at 1070. Such independent counsel is most commonly referred to throughout the United States as *Cumis* counsel, a term deriving from *San Diego Federal Credit Union v. Cumis Insurance Society, Inc.*, 162 Cal. App. 3d 358, 208 Cal. Rptr. 494 (Cal. Ct. App. 1984), which a significant number of courts in other jurisdictions have followed. In some jurisdictions, the right to independent counsel is statutorily mandated. See CAL. CIV. CODE § 2860 (insured has right to independent counsel, but insured can waive that right in writing and have insurer select counsel).

In jurisdictions requiring *Cumis* (or *Moeller*) counsel, the insurer also may have additional duties with regard to advising its insureds of conflicts of interest. For example, in *Maryland Casualty Company v. Nestle*, No. 1:09cv644-LG-RHW, 2010 WL 3735756, at *3 (S.D. Miss. Sept. 17, 2010), the district court recognized the insurer’s “two distinct obligations to its insured – (1) a duty to indemnify its insured for covered claims and (2) a duty to furnish a legal defense to certain claims.” (Citing *Mimmitt v. Allstate Cty. Mut. Ins. Co.*, 928 So.2d 203, 207 (Miss. Ct. App. 2006)). After analysis of the coverage issues, the court found that the Maryland Casualty policy provided no basis for indemnity. The Nestles (the underlying claimants), however, argued that Maryland Casualty was equitably estopped from denying coverage or a defense to Husband (the underlying defendant and Maryland Casualty’s insured) as it had failed to apprise Husband of her rights under *Moeller, supra* (Mississippi’s equivalent of *Cumis*).

Maryland Casualty defended Husband, its insured, under a reservation of rights and assigned insurance panel counsel to the defense. There was a factual dispute whether Husband was advised of the conflicts of interests inherent in Maryland Casualty’s reservation of rights and her rights under *Moeller*. The reservation of rights letter quoted the policy language, including the pertinent exclusionary language, and further stated:

Notwithstanding the foregoing and without waiving its right to disclaim coverage at a later date, the company hereby advises you that it shall defend you against this lawsuit under a full reservation of rights.

Id. at *6.

The letter went on to provide information regarding assigned defense counsel. However, nothing in the reservation of rights letter advised the insured regarding defense counsel's potential conflict of interest, nor did it inform the insured of her right to choose independent counsel, for which Maryland Casualty would pay, subject to a later finding that Maryland Casualty had no duty to defend.

Husband offered sufficient evidence in response to raise a question of fact as to whether Maryland Casualty breached its duties under *Moeller*. Assigned defense counsel claimed to have informed the insured of her right to have counsel of her own choosing at Maryland's expense, but there was nothing in writing.

Whether the carrier is estopped from denying coverage turns, as recognized by the court in *Nestle*, on whether the insured is prejudiced by the insurer's alleged misconduct in fulfilling its duty to defend.

Similarly, in *Liberty Mutual Insurance Company v. Tedford*, 658 F. Supp. 2d 786 (N.D. Miss. 2009), the district court denied summary judgment for the insurer Liberty Mutual as there was evidence that the insured was not informed of its right to *Moeller* counsel. It was undisputed that the insurer never informed the insured about "its *Moeller* rights or any conflicts of interests created by the insurer's defense pursuant to a reservation of rights." *Id.*, at 796. There was a question of fact on prejudice because the insured had an adverse judgment rendered against it in the underlying tort action. There was testimony that had the insured "been advised by Liberty Mutual that [the insured] had the right to choose independent counsel, [the attorney that Liberty Mutual had selected] would not have been the counsel [the insured] would have retained." *Id.* at 798.

Further requirements may exist with regard to the hiring of independent counsel to represent the insured. However, these are discussed in section C. below with regard to the defense attorney's handling of the conflicts of interests that may arise when the insurer hires the attorney to defend its insured under a reservation of rights.

2. Splitting the File

In order to avoid conflicts of interests many insurers "split" their files so that their coverage files are handled separately from their defense files. *See, e.g., Harleysville Lake States Insurance Company v. Granite Ridge Builders, Inc.*, No. 1:06-CV-00397, 2008 WL 4935974, at *11 (N.D. Ind. Nov. 17, 2008) ("Berklich had split the file with another adjuster because he felt it was improper for him to handle both the defense and the coverage issues, knowing that Harleysville needed a full reservation of rights and intended to file a declaratory judgment action."); *World Harvest Church, Inc. v. Guideone Mutual Insurance Company*, No. 1:07-CV-

1675-RWS, 2008 WL 5111218, at *1 (N.D. Ga. Dec. 2, 2008) (“Defendant recognized that there may be coverage issues under the Policy so the file was split, with one claim handler assigned to address the liability issues and one claim handler assigned to the coverage issues.”).¹

The determination of whether and when to split the file may depend on when the insurer received notice of the claim. If it is a “first notice” lawsuit, the insurer, due to timing issues, may not yet recognize any potential conflict. Under these circumstances, the file might not be split until much later when a conflict arises regarding defense and coverage. The insurer should issue a reservation of rights and retain defense counsel to respond to the complaint. Regardless of the timing, the safer course, if potential for coverage exists, is to split the file. This protects the insured’s and the insurer’s interests. This article provides an analytical framework given the dearth of case law on the topic of splitting files.

Prior to suit being filed on a claim, there is generally no need to split a file between coverage and defense. If the insurer has advised its insured of potential coverage issues and reserved its rights in a timely manner, the insurer is entitled to request and use any information provided by its insured in order to investigate liability and coverage. The insured generally has a contractual duty to cooperate with its insurer’s investigation. It is when a suit is filed that the duty to defend is triggered such that the insurer’s defense obligations may create a conflict with its position on coverage, resulting in the potential need to split files.

When an insurer’s first notice of a claim is the complaint in the underlying action, an investigation for liability and coverage should be conducted under a reservation of rights. There is usually not enough time to make an informed decision on the insurer’s duty to defend before the answer is due. As such, an insurer may take one of two courses: 1) the insurer can maintain one claim file and ask the insured’s personal counsel (if such exists) to answer while the insurer continues to investigate coverage, or 2) the insurer can retain defense counsel to answer and defend under a reservation of rights. It is in the second situation that an insurer must decide whether or not it is prudent to split the file between coverage and liability/defense. This decision should be made in light of the case law discussed above.

Splitting the file where independent counsel is employed exclusively to defend the insured is a developing insurance industry standard and is an appropriate mechanism for avoiding the appearance of impropriety. Splitting the file is generally advisable where it is determined that a duty to defend exists but coverage is questionable. “Insurers that fail to establish an adequate conflict screen when their coverage position creates a conflict of interest . . . run the risk of subjecting themselves to significant bad faith liability.” Brent W. Huber and Angela P. Kraulik, *Bad Faith Coverage Litigation: The Insurer’s Covenant of Good Faith and Fair Dealing*, 42 TORT TRIAL & INS. PRAC. L.J. 29, 48-49 (Fall 2006). Even if bad faith liability

¹ It should be noted that the district court in *World Harvest* ultimately held that the insurance company was not estopped from denying coverage after defending its insured for eleven months without out reserving its rights because insured was not prejudiced. However, this issue was appealed, and the Eleventh Circuit Court of Appeals certified the question to the Georgia Supreme Court. *See* 586 F.3d 950 (11th Cir. 2009). The Georgia Supreme Court answered the certified question, holding that a showing of prejudice is not required for estoppel to apply. *World Harvest Church, Inc. v. GuideOne Mut. Ins. Co.*, 695 S.E.2d 6 (Ga. 2010).

is not an issue, an insurer's failure to split files may at least open the doorway to estop its coverage defenses. See *Twin City Fire Insurance*, 309 F.3d at 908.

"The conflict screen must actually and sufficiently protect the policyholder's interest and must not be established as a mere formality." Huber and Krahulik, 42 TORT TRIAL & INS. PRAC. L.J. at 48. See also *Armstrong Cleaners*, 364 F. Supp. 2d 797 (addressing insufficiency of "Chinese wall" erected between front-line adjusters). The question remains, however, how is it to be accomplished?

To avoid potential problems in cases where a lawsuit is filed on an existing claim, the adjuster who had the file prior to suit being filed should keep the liability/defense file, and a separate adjuster should be employed to handle coverage issues. There are two suggested general guidelines with respect to the coverage adjuster's use of information obtained from the insured prior to suit being filed:

1. If the insurer has provided its insured with prompt, pre-suit notice of coverage issues, then the coverage adjuster may access pre-suit information from the insured or elsewhere to determine coverage and/or to plan the defense of the liability claim.
2. If the insurer has not provided its insured with prompt, pre-suit notice of coverage issues, then the insurer should not use information which it has or will obtain to deny coverage or to direct the insured's defense.

Once suit is filed and the file is split, the defense adjuster should not participate in coverage determinations, and the coverage adjuster should not participate in the direction of the defense of the underlying claims. However, the coverage adjuster may request information from the defense adjuster to the extent that such information is public or on the official record (e.g., court filings, deposition transcripts, expert reports, etc.). Assuming that *Moeller* counsel is employed, defense counsel should not disclose to the insurer (including the defense adjuster) confidential information that could result in a denial of coverage to the client, the insured. However, where the file is split, if defense counsel provides such confidential information to the defense adjuster, the defense adjuster should not pass the information along to the coverage adjuster. (That stated, where *Moeller* counsel voluntarily discloses such confidential information to the adjuster where a file is not split, the sole adjuster arguably may not be precluded from using the information in formulating the insurer's coverage position.) See, e.g., *Travelers Indem. Co. v. Page & Assocs. Const. Co.*, No. 07-01-0022-CV, 2002 WL 1371065, at *10 (Tex. Ct. App. June 25, 2002) (holding that sole adjuster in an un-split file did not act inappropriately in using in his coverage analysis, information requested from and voluntarily provided by defense counsel); *State Farm Fire & Casualty Company v. Superior Court*, 216 Cal. App. 3d 1222, 265 Cal. Rptr. 372 (Cal. Ct. App. 1989), discussed *infra*.

With respect to settlement negotiations in split file cases, the liability adjuster should make independent recommendations to the insurer for settlement authority. The coverage adjuster has the right and duty to either accept the liability adjuster's settlement recommendation or to modify or reject it consistent with the insurer's coverage analysis. Both adjusters can

exchange opinions on settlement, but the coverage adjuster should have the ultimate responsibility to take an accurate position on coverage, be fair to the insured, and protect the insured's uninsured interests. As noted by one commentary:

[A]ll conflict screens must end at a threshold point where a decision maker for the insurance company has access to both the liability information and the coverage information in order to determine whether the case should settle. The insurance company's inherent duty to give equal consideration to its insured's interests does not resolve this dilemma. Where there is a coverage issue, the insurance company and the insured are involved in an all or nothing situation. Either coverage exists and, therefore, the insurance company has an obligation to protect the insured's interests within the boundaries of the policy limits, or, if no coverage exists, the insurance company has no obligation to indemnify the insured. Because the nature of the competing interests present in an "all or nothing" fashion, a strict all encompassing conflict screen militates against the insurance company's ability to give equal consideration to the insured's interests in determining whether to settle a potentially covered liability claim.

At some point in the process, the two investigations must intersect with one common decision maker who must then weigh all of the information to determine whether the case should be settled. The question remains as to the appropriate intersection point in the corporate chain of command. . . .

Although not legally necessary, it helps to have the person making the initial decisions on proper settlement amounts for the claim against the insured to not be the same person who makes initial determinations of whether the insurer will decline coverage or what will be paid for settlement of the coverage dispute. A division of these responsibilities helps in the defense against a claim that the final decision by the insurance company was unreasonable.

Steven Plitt & Steven J. Gross, *Splitting Claim Files: Managing the Concern for Conflicts of Interest Through the Use of Insurance Company Conflict Screens*, 32 NO. 6 INS. LITIG. REP. 151 (April 26, 2010).

Ultimately, the insurance carrier will be judged on hindsight with respect to whether its coverage position was correct and whether its settlement authority was reasonable or constituted an unfair impediment to the underlying defense and/or reasonable settlement. Thus, the insurer may be liable for a judgment in excess of its policy limits (or even a finding of bad faith) if its settlement position is based on an incorrect coverage interpretation which results in an uninsured exposure to the insured beyond what would have been the case had the suit been settled pursuant to the defense adjuster's recommendation.

It should be noted that it is not universally recognized that the insurer's failure to "split the file" is improper-in-and-of-itself, provided that the conflicts of interests are otherwise handled appropriately. This issue was addressed in *State Farm Fire & Casualty Company v. Superior Court*, 216 Cal. App. 3d 1222, 265 Cal. Rptr. 372 (Cal. Ct. App. 1989), where the

Court held that as long as the insurer hired independent *Cumis* counsel to represent solely the insured's interests in the underlying action, the insurer could employ a single claims adjuster to handle both the defense of the underlying liability action and the coverage action. In this case, at the time State Farm accepted the defense of its insureds under a reservation of rights, it agreed to pay the defense costs for their *Cumis* counsel. State Farm then retained separate coverage counsel to pursue an action for a declaratory judgment "to establish the lack of coverage." *Id.* at 1225. However, State Farm assigned a single adjuster to manage both cases, and the adjuster "maintained only one file." *Id.* The adjuster "served in a dual capacity, assisting and communicating with counsel defending [the insureds] in the liability case, and at the same time communicating with and assisting the State Farm counsel asserting lack of coverage in the declaratory relief case." *Id.* The evidence showed that the adjuster communicated State Farm's coverage position to the insured's defense counsel, advising defense counsel "that not one penny would be offered in settlement, [and] that State Farm was only obligated to provide . . . a 'defense,' because, in his opinion, there was no coverage under the policy." *Id.*

The insureds argued that State Farm's hiring of *Cumis* counsel was insufficient to protect their interests in the liability action. The Court disagreed, stating as follows:

Durants [the insureds] request that we add a layer of separation to [the *Cumis*] mandate, requiring that not only the counsel involved in the cases but the adjusters assigned to each case (the "liability" case as distinguished from the "coverage" case) be separate—that the files on each case be separate and apart—and indeed, as urged by Amicus Curiae, that a veritable wall be erected between the insurance company's administration of the two cases. We cannot subscribe to this proposition.

Id. at 1226. According to the Court:

The insurance adjuster is the agent of the insurer. That the adjuster can under particular fact situations become also the agent of the insured is clear, and this most usually will occur when no issue as to coverage arises. Where coverage is in issue, however, it is obvious that the adjuster's loyalties are divided and the insured and his counsel cannot reasonably expect that he represents only the interest of the insured. Indeed, it is to remedy this problem that the concept of the *Cumis* counsel has been created.

The existence of independent *Cumis* counsel adequately protects, we believe, the interests of the insured. In these days of ever-increasing costs in the processing of insurance settlements, we conclude it would be unwise to impose yet another layer of administration.

Id. at 1227 (internal citations omitted).

The Court noted that the adequacy of independent *Cumis* counsel in such situations is bolstered by "recent legislation which affirms the principle stated in *Cumis*, that 'privileged materials relevant to coverage disputes' need not be reported to the insurance company." *Id.*

(citing CAL. CIV. CODE § 2860, subd. (d) (eff. Jan. 1, 1988)). The Court held that it is *Cumis* counsel's "obligation to guard against improvident revelations to the insurance company" and *Cumis* counsel must assume that communications to the insurer's adjuster are the same as communications to the insurer itself. *Id.* at 1228.

The Ninth Circuit Court of Appeals subsequently decided a similar case in *Employers Insurance of Wausau v. Albert D. Seeno Construction Company*, 945 F.2d 284 (9th Cir. 1991) (Cal.). In this case, the insured (who was the Amicus Curiae referenced in *State Farm Fire & Casualty Company, supra*) sought "injunctive relief requiring [its liability carrier] to segregate its liability claims handling from its coverage investigation," arguing that the insurer had "used the investigation and settlement of [certain claims not yet in litigation] to gather information for the coverage dispute against [the insured]." *Id.* at 285. Taking its lead from *State Farm Fire & Casualty Company*, the Ninth Circuit held that "the relationship [between the insurer and its insured in the reservation of rights context] does not require segregation of liability and coverage files." *Id.* at 288. According to the Court:

Seeno's [the insured] argument that most other carriers in the California insurance industry choose to segregate their liability and coverage activities does not establish that it is Wausau's [the insurer] duty to do so. As stated above, the nature of Wausau's duty to its insured does not require such a segregation. The fact that other carriers may choose to segregate does not necessarily arise out of any duty to do so, but may arise from a precautionous decision to avoid later complaints of mishandling from the insured.

Id. at 288.

Similarly, where the file was split, but there was "cross-over,"² the Court in *Flynn's Lick Community Center & Volunteer Fire Department v. Burlington Insurance Company*, No. M2002-00256-COA-R3-CV, 2003 WL 21766244 (Tenn. Ct. App. 2003), determined that the jury's verdict in favor of the insurer was supported. In this case, three lawsuits were filed against the insured (Flynn's Lick), which it tendered to its insurer (Burlington). Burlington adjuster B.J. Cleaver then wrote Flynn's Lick a letter, "stating that the lawsuits gave 'rise to some potential coverage questions under the . . . insurance policy,'" but agreeing to defend Flynn's Lick under a reservation of rights. *Id.* at *2. Thereafter, Burlington retained Flynn Lick's defense counsel. "After the investigation of coverage had begun, Burlington assigned adjuster Cleaver to handle the defense of Flynn's Lick," and assigned a separate adjuster, Claude Fulbright, to handle the coverage issues and attorney Parks Castain as coverage counsel. *Id.* Chastain advised Burlington that he did not believe there was coverage. Thereafter, Cleaver (the defense adjuster) wrote Flynn's Lick a letter stating Burlington's coverage position, and advising that Burlington was planning to file a declaratory judgment action, which it subsequently did. Later, Fulbright (the coverage adjuster) and defense counsel attended a settlement conference where the underlying lawsuits were settled. Then the declaratory judgment action was dismissed. Flynn's Lick's request for attorney's fees incurred in defending against the declaratory judgment action

² "Cross-over" refers to the situation that exists when the file is split, but information is shared between the liability/defense adjuster and the coverage adjuster or one of the adjusters performs a function which should be reserved for the other.

was denied. As a result, Flynn's Lick filed a lawsuit against Burlington, alleging that Burlington's actions constituted a violation of the Tennessee Consumer Protection Act, *Tennessee Code Annotated* § 47-18-101, *et seq.*

During this action, Burlington submitted an affidavit of Cleaver (the defense adjuster), which set forth "the reasons for her belief that there was no coverage for the Flynn's Lick claims." *Id.* at *4. Citing this affidavit,

Evans [Flynn's Lick's attorney in the declaratory judgment action] [testified that he] was of the opinion that Cleaver's position was contrary to Burlington's own company policy of splitting the files between the defense and coverage aspects of a case. Evans stated his opinion that Burlington treated Flynn's Lick unfairly because, he believed, Burlington did not actually split responsibility to the Flynn's Lick file between adjusters Cleaver and Fulbright. Evans reasoned that because Cleaver was the adjuster assigned to defend Flynn's Lick in the underlying suits, Cleaver's affidavit stating that coverage did not exist was irreconcilable with her duty to represent the interests of Flynn's Lick. From this, Evans concluded that Burlington did not actually split the files as it should have.

Id.

In response to Evans' testimony, Burlington submitted the testimony of Chastain, its coverage counsel. According to the Court:

Consistent with Evans' testimony, Chastain said that insurance companies frequently split files between the defense and coverage aspects of a case, because the adjuster handling the defense aspect has different duties than the adjuster handling coverage issues. The two should not have contact with one another so that the insured is protected from the danger of having the coverage adjuster control the actions of the liability adjuster. Chastain stated that he never talked to defense adjuster Cleaver, and that he worked only with Fulbright.

Chastain asserted that there was no conflict in coverage adjuster Fulbright making the decision to settle the underlying claims. Although Fulbright's action constituted a type of "crossing over" from the coverage side to the defense side of the proverbial "wall," Chastain explained, Fulbright was essentially waiving the coverage defense by agreeing to pay Flynn's Lick's claim and, thus, was justified in breaching the wall.

Chastain also testified that it was not inappropriate for defense adjuster Cleaver to sign the August 1998 letter to Flynn's Lick, called the "reservation of rights" letter, because such a letter is "typically sent from the liability adjuster to the insured." He explained that the December 30 letter, advising Flynn's Lick of the impending declaratory judgment action, was simply "an updating of the reservation of rights" letter. Under these circumstances, Chastain asserted, it was not inappropriate for Cleaver, as the defense adjuster, to write that letter. Chastain

said that, though Cleaver signed the affidavit he filed for Burlington in support of the declaratory judgment action, Chastain never talked to Cleaver. Chastain said that he sent the affidavit to Fulbright for Cleaver's signature because Cleaver was the person who signed the letters written to Flynn's Lick.

Id. at *5.

After hearing all of the evidence, the jury issued a verdict in favor of Burlington. Flynn's Lick then appealed the trial court's denial of its motion for a new trial. On appeal, Flynn's Lick argued "that the jury's verdict was contrary to the weight of the evidence," emphasizing "the fact that Burlington permitted coverage adjuster Fulbright and defense adjuster Cleaver to 'cross over' the wall between the defense and coverage aspects of the claims, arguing that this established that Burlington acted unfairly and improperly." *Id.* at *9. The Court rejected this argument, holding that "there was material evidence to support the jury's conclusion," and noting that "Burlington introduced into evidence testimony which provided the jury a cogent explanation for its actions and decisions." *Id.*

While the cases above demonstrate that some courts have held that a carrier's failure to "split the file" is not in-and-of-itself improper, other jurisdictions have indicated that such at least may be evidence of an insurer's breach of the duty to defend its insured if not evidence of bad faith. For example, in *Twin City Fire Insurance Company v. City of Madison, Mississippi*, 309 F.3d 901 (5th Cir. 2002) (Miss.), several developers sued the City of Madison in federal district court, and the City was defended by its insurer, Twin City, under a reservation of rights. Twin City retained defense counsel to defend the insured. Twin City subsequently brought a declaratory judgment action against the City, seeking a declaration that no coverage existed under its policy. While the district court and the Fifth Circuit both agreed that coverage was excluded under the terms of the policy, the City argued "that Twin City should be estopped from denying liability under the policy because of various claims handling violations and breach of the duty to defend." *Id.* at 905. Specifically, the City argued that there was a conflict of interest between itself and Twin City, in that counsel appointed by Twin City "wanted coverage for his client the City, and Twin City [sought] to avoid coverage." Counsel "reported to both [the City] and Twin City's claims adjusters about the defense of the matter"; and "Twin City improperly utilized privileged information from [counsel in the] claim file to develop Twin City's position of non-coverage." *Id.* at 905-06. The Fifth Circuit held that, in light of the foregoing issues of fact, a trial was necessary to determine "whether Twin City discharged its duty to defend or mishandled the claim" which could "estop Twin City from denying liability":

The evidence presents a genuine issue of fact regarding prejudice, because the very ruling obtained by [defense counsel] in favor of the City [in the underlying liability action] was used against the City in this coverage dispute. Had it known earlier, the City could have hired its own attorney who might have foregone the [argument asserted by defense counsel in the underlying action upon which Twin City's coverage position was based]. A reasonable fact finder might believe that [the City] relied on Twin City's conduct in assuming the defense and did not know until three weeks before trial that it had no truly independent counsel. One might find that Madison learned only within that month before trial

that its insurer had hired counsel to defeat coverage, was using [defense counsel's] work product against [the City], and was suing [the City] for the costs of defense over the past five years. *Moeller [v. American Guaranty & Liability Insurance Company]*, 707 So. 2d 1062 (Miss. 1996) – Mississippi's version of *Cumis*] recognized that allowing an insured the opportunity to select its own counsel to defend the claim at the insurer's expense can prevent such prejudice as the insurer gaining “access to confidential or privileged information in the process of the defense which it might later use to its advantage in litigation concerning coverage.” *Moeller*, 707 So. 2d at 1069 (quoting *CHI of Alaska, Inc. v. Employers Reinsurance Corp.*, 844 P.2d 1113, 1116 (Alaska 1993)).

Id. at 908 (footnote omitted).

Moreover, in addition to possibly supporting a claim for coverage by estoppel, the Court held that the insurer's actions also could support a claim for bad faith. According to the Court:

In addition to the issues of fact concerning breach of the duty to defend discussed above, [the City] has demonstrated a number of other issues of fact: whether [the adjuster] was involved in both claims analysis and coverage analysis, prejudicing the insured with a conflict of interests; whether [the insurer] adequately separated claim-handling responsibility from coverage analysis; whether [the adjuster] remained silent about a conflict of interests while developing a strategy of noncoverage; whether [the adjuster] ever told [defense counsel] that she and [another adjuster] were involved in coverage, though she instructed him to send them both status reports containing confidential information received from the client, detrimental to coverage; whether [the other adjuster] relied on confidential information from [defense counsel's] status reports to develop a coverage defense or in deciding to hire independent coverage counsel; whether coverage counsel conducted any investigation besides the one performed by [defense counsel]; whether the entire claims file was forwarded to [coverage counsel] to formulate its non-coverage position; whether third-party defendants relied on [defense counsel's] legal defense against the underlying claims to formulate a strategy to defeat coverage in this action

These facts in dispute leave a question regarding third parties' gross negligence in claim handling. A fact finder might consider that coverage analysts having unfettered access to privileged information from appointed defense counsel in the presence of an undisclosed conflict support the tort claims asserted herein. . . .

Id. at 909 (footnote omitted).

In *Armstrong Cleaners, Inc. v. Erie Insurance Exchange*, 364 F. Supp. 2d 797, 801 (S.D. Ind. 2005), after the insureds (the Armstrongs) tendered the defense of the underlying liability action to Erie, their insurer, Erie accepted the defense under a reservation of rights but “insist[ed] on using counsel of its own choice to defend the Armstrongs in the underlying lawsuits.” The

Armstrongs “filed suit to force Erie to pay for counsel of their choice,” arguing that “counsel selected by Erie [would] have a conflict of interest because issues as to which Erie has reserved its rights are likely to be litigated and decided in the underlying lawsuits.” *Id.* The Armstrongs also “assert[ed] a claim for bad faith denial of coverage.” *Id.* Erie argued that there was no “significant conflict of interest,” requiring it to hire independent counsel for the Armstrongs under Indiana law, “because of the ‘Chinese Wall’ procedures it ha[d] implemented by dividing its file between one claims adjuster to work on the defense of the [underlying] action and another claims adjuster to work on the coverage issue.” *Id.* at 817. The court rejected Erie’s argument. According to the court:

Both adjusters work in the Indianapolis claims office. The two adjusters maintain their own files and do not have access to the other’s file, and the two adjusters are prohibited from talking about this matter with one another. There is no indication, however, that the “Chinese Wall” extends any higher than those two adjusters to include their supervisor(s) or others who would exercise final authority for Erie on issues that might arise, such as settlement or other major strategic decisions. Also, the defense adjuster has a copy of the reservation of rights letter that identifies the coverage issues.

Id. at 805. The court reiterated

The procedures are limited to the front-line adjusters. There is no indication that they apply to more senior supervisors of both adjusters, including those who would have to approve payment of the attorney fees and any settlement. In addition, the adjuster handling the defense issues has a copy of the reservation of rights letter and must be presumed to understand the coverage issues.

Id. at 817.

Based on these facts, the court granted the Armstrongs’ motion for summary judgment with respect to requiring Erie to pay for independent counsel to represent their insureds. However, the court also granted Erie’s counter motions for summary judgment with respect to the Armstrongs’ bad faith claim, holding that “[t]he undisputed facts show that Erie had a reasonable basis for denying the Armstrongs’ request for independent counsel.” *Id.* at 818.

In *Specialty Surplus Insurance Company v. Second Chance, Inc.*, 412 F. Supp. 2d 1152, 1155 (W.D. Wash. 2006), at the beginning of the lawsuit against its insured, “Specialty Surplus [the insurer] assigned a single insurance adjuster to manage the defense of all claims regarding both [its primary insured and its insured employee].” The file was split later so that two defense files existed, one for each insured, due to a potential conflict of interest between the insureds. The district court held that the “commingling of the files of two *defendant-insureds*” had no “bearing on the existence of a conflict of interest between the *insurer* and the *insured*,” and did not otherwise demonstrate the insurer’s greater concern for its own monetary interests than for its insured’s. *Id.* at 1169 (emphasis in opinion). The court denied the insured’s motion for summary judgment with respect to its bad faith claim against the insurer based on its failure to split the file earlier.

Months later, the district court re-examined the issue on Specialty Surplus's motion for summary judgment, and again held that there was nothing "to substantiate the argument that Specialty Surplus had a duty to split the files earlier than it did." *Specialty Surplus Insurance Company v. Second Chance, Inc.*, No. C03-0927C, 2006 WL 2459092, at *15 (W.D. Wash. Aug. 22, 2006). However, this time there was an argument that even after the files were split, there was impermissible "cross-file communication." *Id.* at *16. The court noted that most of the communications at issue were nothing "more than an immaterial matter of internal procedure," but that "there [were] also notes indicating that the separation between the files was occasionally functional." *Id.* According to the court:

[T]he notes could support a factual finding, that Specialty Surplus improperly used the information garnered from both files to come to the conclusion that it was in Specialty Surplus's best interests to allow the underlying matter proceed to trial, because of its coverage defenses. The notes could be interpreted as evidence that Specialty Surplus was not willing to make more efforts to settle [the insured employee's] case because it was becoming clearer that it would be able to assert an effective coverage defense and disclaim coverage after the underlying trial.

Id.

Thus, the court denied this portion of Specialty Surplus's motion for summary judgment on the bad faith claims "with respect to its handling of the file split." *Id.* at *17. It should be noted that it is not entirely clear whether Specialty Surplus retained independent *Cumis* counsel for its insureds. That stated, Washington law imposes a duty upon insurers in a reservation of rights defense to "retain competent defense counsel for the insured, and both retained defense counsel and the insurer must understand that only the insured is the client." *Johnson v. Continental Cas. Co.*, 788 P.2d 598, 600 (Wash. Ct. App. 1990) (citing *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash. 1986)).

C. Defense Attorney's Response to Conflicts

Not only does the liability insurance company have duties and obligations to uphold, but also mixed into this potential "collision" are the ethical obligations of any attorney. A defense attorney who is retained by an insurer pursuant to a reservation of rights walks a very fine line. The "ethical and professional obligations" of defense counsel in such situations were identified in *Moeller* as follows:

The attorney selected and employed by the insurance carrier, of course, has an ethical and professional obligation to represent the company. That attorney is the carrier's attorney. This attorney also has an ethical and professional obligation to represent the insured in the defense of the claim, thus representing two separate and distinct clients. Routinely, and in the vast majority of cases, defense counsel is presented with no conflict of interest between the two. The claim is covered by the policy, and the insurance carrier will pay in full any judgment rendered against the insured. Yet, such counsel must be careful at the time he is asked to represent the insurance carrier and the insured, and if there is

any reason indicating a possible conflict of interest at the time of his employment, he should under no circumstances undertake to represent them both. Furthermore, any attorney representing two clients must remain on alert and ever watchful for any possible conflict of interest arising between the two, because the moment that happens, counsel should not attempt to represent them both.

When an attorney is offered employment by an insurance carrier, he should first ascertain if there is any reason there might be a conflict in representing the carrier and the insured. Is the carrier defending under a reservation of rights? Is the amount sued for in excess of the policy limits? Is it possible that a portion of the claim may be covered, and another not, or that the policy covers one theory of liability, but not another one? If so, he should undertake to represent only the interest of the insurance carrier for the part covered, and the insurance carrier should afford the insured ample opportunity to select his own independent counsel to look after his interest.

Moreover, if during the representation of both parties a conflict of interest arises, defense counsel should withdraw from representation of either if there is any possibility that representing one and not the other may be injuries to the client the attorney ceases to represent.

707 So. 2d at 1070 (internal citations and footnote omitted).

In general, an attorney's conduct in relation to his or her client is guided and controlled by the Rules of Professional Conduct. The traditional rule is that defense counsel is in a tripartite relationship between the insurer and the insured. Under this traditional rule, both the insurance company and the insured are clients of the defense counsel. It is the insured, however, who must be protected and whose best interests control the defense counsel. However, the Mississippi Supreme Court in *Moeller* deviated from the "traditional" tripartite relationship by stating that counsel retained by the insurer to defend the insured is the insurer's lawyer. *Id.* Thus, where counsel is retained by the insurer to defend the insured under a reservation of rights, defense counsel's obligations to the insured client are scrutinized by the courts. *See, e.g., Twin City Fire Insurance*, 309 F.3d 901 (5th Cir. 2002) (Miss.); *Nestle*, 2010 WL 3735756 (S.D. Miss. Sept. 17, 2010); *Tedford*, 658 F. Supp. 2d 786 (N.D. Miss. 2009).

The Model Rules of Professional Conduct provide for the scope of representation and allocation of authority between the client and the lawyer:

Rule 1.2. Scope of Representation and Allocation of Authority Between Client and Lawyer:

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.

Rule 1.4. Communication:

(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 the matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.

Regardless of who is identified as the "client," generally, when a defense lawyer is in a tri-partite relationship, the ethical obligations set forth above may conflict as between duties owed to the insurance carrier and the insured/defendant. This conflict becomes even more apparent when one considers Rule 1.6(a), which provides that a lawyer shall not reveal confidential information relating to the representation of the client, without the client's informed consent.

Common issues involving confidentiality and communications by defense counsel concern what information should be provided to the insured and the insurer and what information should be withheld from either. For example, liability policies usually do not provide coverage for damages that are caused intentionally. This begs the question of whether an attorney is obligated to inform the insurer of information that might provide coverage defenses. In general, an attorney is to maintain the privileged and confidential information of a client. However, under certain circumstances an attorney may disclose all information that is reasonably necessary to secure information relating to the representation, to establish a claim or defense of the lawyer in a controversy between the lawyer and the client, or to comply with a court order.

There is a split amongst jurisdictions regarding the disclosure of this type of confidential information between the insurer and the insured. The question begins with "who is the 'client.'" Outside of *Moeller*, in some jurisdictions such as Alabama and Minnesota, the policyholder and

the insurer have been considered “dual” or “joint” clients. Joint clients generally have no expectations of confidentiality between themselves with respect to matters on which they are jointly represented. *See, e.g., Mitchum v. Hudgens*, 533 So. 2d 194, 198 (Ala. 1988); *Shelby Mut’l Ins. Co. v. Klenman*, 255 N.W.2d 231, 235 (Minn. 1977).

Other states take a different view of the relationship and hold only the insured/policyholder to be the “primary” client. *See, e.g., Paradigm Ins. Co. v. Langerman law Offices*, 24 P.3d 593, 602 (Ariz. 2001) (although the insurer was not the “client,” the defense lawyer nonetheless owed a duty to the insurer); *State Farm Mut’l Auto v. Federal Ins. Co.*, 86 Cal. Rptr. 2d 20 (Cal. Ct. App.1999).

In other states, Texas, Montana, Michigan and Connecticut, the law is clear that the policyholder is the only client. *See, e.g., Safeway Managing General Agency, Inc. v. Clark & Gamble*, 985 S.W.2d 166, 168 (Tex. App.- San Antonio 1998) (no attorney-client-relationship exists between an insurance carrier and the attorney it hired to defend one of the carrier’s insureds); *Bradt v. West*, 892 S.W.2d 56, 77 (Tex.App. – Houston [1st Dist.] 1998); *State Farm Mut’l Auto Ins. Co. v. Traver*, 980 S.W.2d 825-27(Tex. 1998) (the attorney owes unqualified loyalty to the insured.) These states are often referred to as one client states and often times there is substantial friction between the insurance carrier’s demand for file information and the client’s expectation of confidentiality.

Model Rule 1.7 sets forth the attorney’s duty of loyalty. An attorney shall not represent a client if the representation will create a conflict of interest. The Rule sets for various scenarios in which a conflict may occur, including one in which “there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to . . . a third person.” Rule 1.7(a)(2). If a conflict of interest arises, the attorney must withdraw from representation unless the conflict is one to which a client validly may consent under the requirements of Rule 1.7(b) and each client affected gives informed consent in writing.

With respect to conflicts in the tripartite relationship, the *Restatement (Third) of Law Governing Lawyers* affirms that the lawyer should “proceed in the best interests of the insured . . . and, if applicable, consistent with the lawyer’s duties to the insurer as co-client.” *Restatement (Third) of Law Governing Law.*, § 134, at 410. Under Rule 1.7, if the lawyer cannot work under the direction of the insurer while still advancing the best interests of the insured, then the lawyer must withdraw from representation. He or she may not abide by any insurer instructions that adversely and materially impact the insured. *Restatement*, §134, at 409-10; Rule 1.8.

A lawyer may avoid potential conflicts at the outset, however, by specifically delineating the scope of his or her representation as early as possible in the litigation. The carrier may avoid or minimize the conflicts of interest internally and for its lawyer by splitting files within the insurance company.

As a practical pointer, the coverage side of the file must know at least as much as the defense side or otherwise the insurance company can be sued for bad faith if it denies the claim. This is where the lawyer is caught on the quintessential “tightrope” of his/her client loyalties. Information must be shared between the two sides of the file – but it is crucial to do so without

the “appearance of impropriety.” See, e.g., *Nationwide Mut. Fire Ins. Co. v. Masseria*, No. 98-G-2200, 1999 WL 1313626 (Ohio Ct. App. Dec. 17, 1999). The sharing of information, which may be harmful to the policyholder/client, must be done with care. For example, if harmful testimony is learned in depositions, the lawyer should not highlight that testimony to the carrier – he or she should report on the liability aspects of the case. The deposition transcript may also be provided to the carrier and the coverage side may review it independently.

D. Conclusion

Both the insurance carrier and the defense attorney hired by the carrier to represent the insured must be aware of the potential conflicts of interest that arise between the carrier and its insured, particularly when the carrier is defending its insured under a reservation of rights. If the conflicts are not handled appropriately, the insurer may be estopped from denying coverage or even be found to have acted in bad faith. In order to avoid such problems, the insurer can (and in some instances may be required to) retain independent counsel to represent the interest of solely the insured, advise the insured of its rights to such independent counsel, and split the file between liability/defense and coverage issues. Likewise, any defense attorney retained by an insurance carrier to represent its insured must be aware of potential conflicts so as to fulfill his or her ethical and professional obligations. In determining what those obligations are and how they are to be fulfilled in the realm of the tri-partite relationship between the carrier, the attorney, and the insured, the best rule to follow, as always, is to research thoroughly the relevant rules, statutes, and case law in the applicable jurisdiction.



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What a Difference a Year Makes: 2014 & 2015 Coverage Developments



Presenter:

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Voss v. Netherlands Ins. Co.

Broker Liability law.

- Substantially expands broker liability law in New York
- Since *Murphy v. Kuhn*, broker is an order taker under NY law, except if there is a special relationship. No case found a special relationship, or explained what it was
- In *Voss*, New York Court of Appeals denied insurance company's motion to dismiss because of lack of special relationship. Court relied on advice given by broker to client over time, particularly as to what policy limits client needed.

In Re DEEPWATER HORIZON

- Issued February 13, 2015.
- On Certified Questions from the 5th Circuit.
- The Court Found because the drilling contract did not make Transocean liable for subsurface pollution, Transocean was not “obligated” to insure BP against that risk.
- BP was not an additional insured under Transocean’s insurance policies.

National Union Insurance Company v. TransCanada

- Insurance company has no attorney client privilege with attorneys serving as claims handler until insurance company denies coverage. Insurance company's ordinary business is to handle claims. That does not become privileged just because the insurance company uses an attorney for that task.
- Communications containing legal advice remain privileged.

Advantage Buildings & Exteriors, Inc. v. Mid-Continent Casualty Co.

- Missouri Court of Appeals.
- Issued September 2, 2014.
- Court found 2 reservation of rights letters were not effective.
- Because the reservation of rights letters were ineffective, Mid-Continent was estopped from denying coverage.
- Although the Court ruled the policy did not explicitly cover the claims, because Mid-Continent failed to effect a proper reservation of rights, it was prohibited from asserting only limited coverage for the claim.
- Mid-Continent was estopped to deny coverage for the claim to the extent of its policy limits.

United States Bank v. Indian Harbor

- Class action sought the return of overdrafts from bank. Insurer argued that ‘uninsurable’ or ‘ill-gotten gains’ provision applied
- Court rejected and held that provision only applied if there is a final adjudication’
- Insurance company unsuccessfully argued that ‘final adjudication’ language is in exclusion and cannot be used to expand coverage.

Preisler v. General Casualty Ins. Co.

- Wisconsin Supreme Court.
- Decided December 30, 2014.
- Held that the Pollution Exclusion applies to cow manure that contaminates a well.
- Recognizes that cow manure may be a desirous substance when used as fertilizer on a farm field, but is a contaminant when it contaminates a well.

K2 Inv. Group v. American Guar. & Liab. Ins. Co.

- In 2013, NY Court of Appeals held that insurer who wrongly denied duty to defend was estopped from asserting policy exclusions. K2-1
- Court then agreed to rehear the case and reversed itself.
- It found that it had overlooked a prior case, Servidone, which it said was adverse to its decision in K2-1.

Wilson Mutual Ins. Co. v. Falk

- Wisconsin Supreme Court.
- Decided December 30, 2104.
- Found the pollution exclusion applied to septage.
- Court found septage to be a pollutant when it seeped into the water supply.

Temple Fuente Da Vida Corp. v. National Union Fire Insurance Company, 2014 N.J.Super. Unpub. Lexis 1303 (N.J. App.Div.June 6, 2014)

- Claims-Made policy contained clause stating that the policyholder must give notice ‘as soon as practicable.’
- Policyholder gave notice within the policy period, six months after it first received notice.
- Court held that six months was not ‘as soon as practicable,’ and denied coverage.

Acuity v. Chartis Specialty Ins. Co.

- Wisconsin Supreme Court
- Decided March 17, 2015
- Dispute between a CGL carrier and a contractors pollution liability (CPL) insurer.
- At issue was an explosion of a natural gas pipeline and a fire.
- Court found the natural gas that escaped from the pipeline was a “contaminant” and thus a “pollution condition” within the meaning of the CPL policy.
- The CPL policy did not require the contaminating nature of the substance to cause the damage in order to trigger coverage.

IMO Industries v. Transamerica Corporation

- New Jersey Appellate Division addresses trigger and allocation issues.
- New Jersey Appellate Division. Over 100 pages. Parts are unintelligible.
- Excess insurer can't challenge underlying settlements.
- Stub policies.
- Multi-year policies.
- Right to jury trial.

IMO Industries v. Transamerica Corporation

- Indemnity losses, rather than actual payments, exhaust policy for purpose of terminating duty to defend.
- Court may displace policy terms if contrary to Owens-Illinois/Carter Wallace.

Allstate Property & Casualty Ins. Co. v. Wolfe

- Pennsylvania Supreme Court.
- Decided December 15, 2014.
- Bad faith claims brought pursuant to 42 Pa. C. S. § 8371 may be assigned by an insured to an injured third party.

Zurich Am. Ins. Co. v. Sony Corp. of Am., Index No. 651982/2011, 2014 N.Y. Misc. LEXIS 5141 (N.Y. App. Div. Feb. 24, 2014)

- Sony argued for partial summary judgment on duty to defend
- Insurance companies argued no publication
- Insurance companies won
- “Publication” requires an affirmative act by the policyholder. Data breach does not involve an act by the insured – no publication
- Has already been argued on appeal in NY

Lucero v. Northand Ins. Co.

- Supreme Court of New Mexico.
- Decided March 26, 2015.
- The issue was whether a \$1M commercial auto insurance policy limit per “accident” applied to limit the per-accident coverage to \$1M regardless of the number of vehicles involved or whether each vehicle was covered up to \$1M.
- The district court granted summary judgment in favor of the insured, holding that the policy limit was \$1M per accident, regardless of the number of vehicles involved; the court of appeals reversed and remanded.
- The supreme court reversed the court of appeals, holding that the policy clearly limits the amount the insurer will pay for damages resulting from one accident to \$1M.
- This case stands alone.

National Union Fire Ins. Co. v. Coinstar, No. C13-1014-JCC, 2014 U.S. Dist. LEXIS 109338 (W.D. Wash. Aug. 7, 2014)

- Exclusion – for violating any statute that “addresses or applies to the sending, transmitting or communicating of any material or information, by any means whatsoever”
- First Class Action – sending customer information to third parties – no coverage
- Second Class Action - Song Beverly Act no publication – no coverage

Nw. Airlines, Inc. v. Prof'l Aircraft Line Serv.

- 8th Circuit Court of Appeals.
- Decided January 14, 2015.
- At issue was whether insured's failure to provide notice to its insurer or cooperate in litigation allowed the insurer to avoid liability for a default judgment in favor of the airline.
- Airline gave insurer actual notice of its claim, the lawsuit, and the possibility of default judgment, and insurer made the decision not to participate in litigation.
- An insured's failure to notify the insurer does not relieve the insurer of an obligation to pay damages where "(1) the insurance policy at issue [was] purchased to comply with the requirements of a statute; and (2) the plaintiff [was] an injured member of the public within the class protected by the statute."

Hartford Cas. Ins. Co. v. Corcino, CV 13-3728, 2013 U.S. Dist. LEXIS 152836 (Cal. Dist. Ct. App. Oct. 7, 2013)

- Posting medical information on public website
- No coverage for right of privacy created by law
- Coverage – common law right to privacy

Hanover Am. Ins. Co. v. Balfour

- 10th Circuit Court of Appeals.
- Decided January 21, 2015.
- Professional liability policy did not cover chiropractor's alleged acts or omissions in failing to warn underage patient of husband's sexual predation where he was not involved in treating patient.
- General liability policy did not cover alleged acts because they did not constitute "personal and advertising injury."

Recall Total Info. Mgmt. v. Federal Ins. Co., 83 A.3d 664 (Conn. App. Ct. 2014)

- 130 IBM computer tapes fell off a truck - contained sensitive personal information
 - Tapes were never recovered - no evidence that tapes were published or accessed
- Recall Management Loss - \$6,000,000
- No publication because no access to information

Sletten & Brettin Orthodontics, LLC v. Cont'l Cas. Co.

- 8th Circuit Court of Appeals.
- Decided March 19, 2015.
- Policy covers intentional acts but excludes coverage for acts committed with the intent to injure – it covers defamation in general, an intentional act, but excludes coverage for defamation committed with the intent to injure.
- No duty to defend because underlying complaint alleges intent to injure in each claim; duty not affected by state law that does not require intent to injure to prove defamation.

St. Paul Mercury Ins. Co. v. Federal Deposit Insurance Corp., et al.

- Ambiguity is created when courts interpret a term differently. Ambiguity leads court to adopt pro-insured construction.

Gen. Refractories Co. v. First State Ins. Co.

- Eastern District of Pennsylvania.
- Decided March 3, 2015.
- “Asbestos” is not the same as “asbestos-containing product.”
- The plain meaning of the term “arising out of asbestos” in the policy is ambiguous, therefore asbestos exclusion is not enforceable.

Century Surety Co. v. Casino West, Inc. No. 60622 (Nev. 2014)

- Carbon Monoxide Poisoning
- Insurance company — carbon monoxide is pollutant — court finds this reasonable
- Policyholder — courts have found that exclusion only applies to traditional pollution - court also agrees
- Court holds that exclusion is ambiguous and that policyholder wins

Wilshire Ins. Co. v. Poinciana Grocer, Inc.

- Florida Court of Appeals, Fifth District.
- Decided November 7, 2014.
- Assault and battery exclusion applies to negligence claim against insured arising from the battery of the injured party on the insured's property.

Smith v. Georgia Farm Bureau Mutual Ins. Co., (Ga. Ct. App. 2015)

- Does absolute pollution exclusion clause apply to injury arising from lead-based paint.
- Court finds that pollution exclusion is ambiguous because lead paint is not specifically excluded

Margulis v. BCS Ins. Co.

- Appellate Court of Illinois, Fourth Division.
- Decided November 26, 2014.
- E&O policy excluded coverage for TCPA claims arising from robocalls made by insurance agent to non-clients.
- Claims did not constitute a negligent act, error or omission arising out of the conduct of insured's business in rendering services for others as an insurance agent; insured did not render services for call recipients where those recipients were not insured's clients or customers.
- Appeal pending.

Public Service Enterprise Group v. Ace American Insurance Company, et al.

Superstorm Sandy - \$500,000,000 loss

- Public Service — electric company.
- Issue is application of sublimits.
- Flood vs. storm surge.
- Proximate cause doctrine.

Everest Indem. Ins. Co. v. Rea

- Court of Appeals of Arizona, Division 1.
- Decided January 15, 2015.
- Insurer entered settlement exhausting liability coverage.
- No implied waiver of attorney-client privilege in subsequent bad faith action where insurer-client admitted that it consulted with attorney prior to settling but did not affirmatively claim that its conduct was based on advise of counsel.

Gregory Packaging v. Travelers

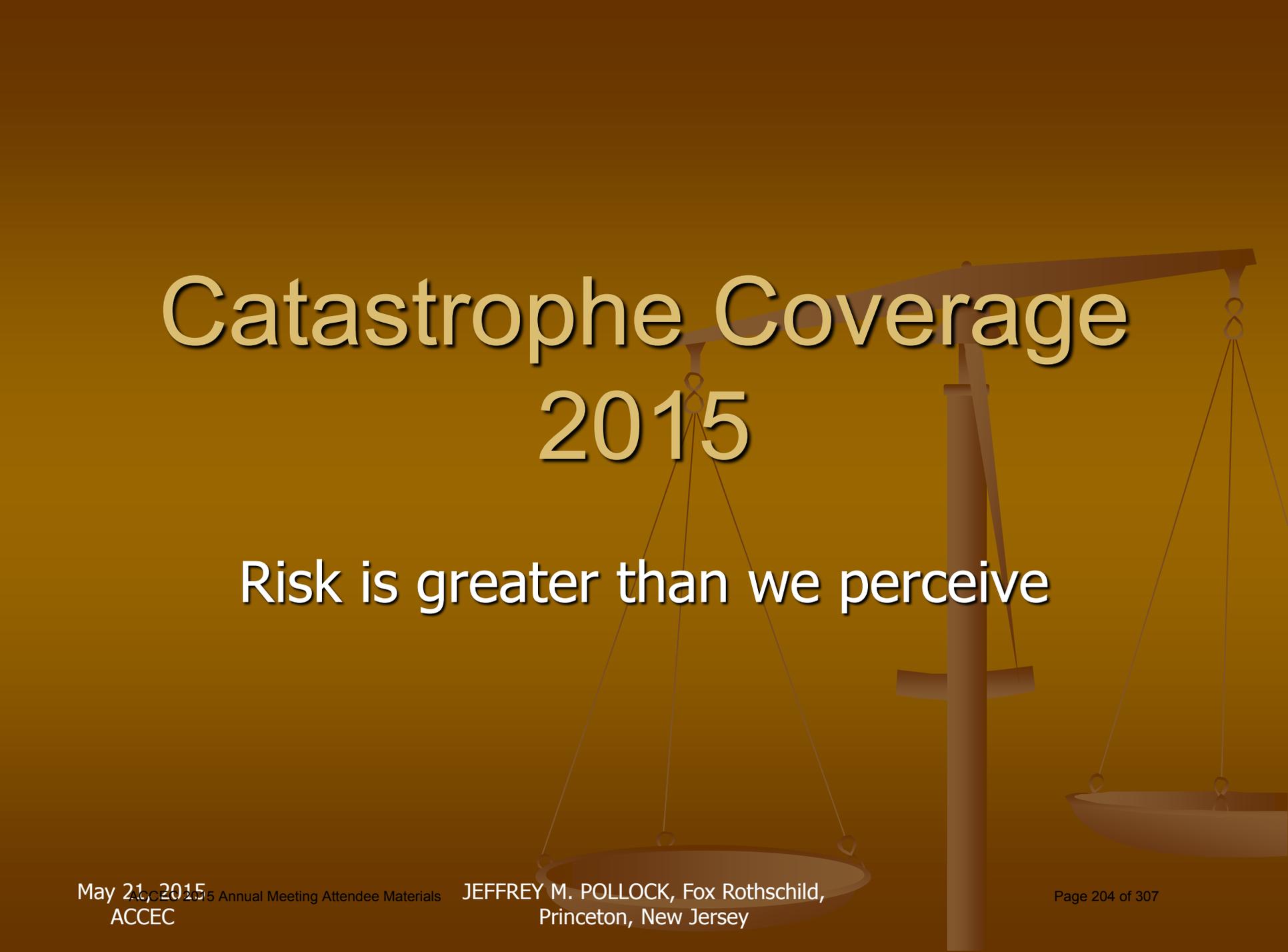
- Property insurance policy covered “direct physical loss of or damage to” the policyholder’s property.
- Ammonia was released during the commissioning of an ammonia refrigeration system – the building was evacuated a remediation company was hired to dissipate ammonia from the building, and the building was rendered un-inhabitable for approximately one week.

Gregory Packaging v. Travelers

- Court held that the ammonia discharge inflicted “direct physical loss or damage” to the facility “because the ammonia physically rendered the facility unusable for a period of time.”
- Court held that “property can sustain physical loss or damage without experiencing structural alteration.”

Travelers Prop. Cas. Co. of Am. v. Kaufman & Broad Monterey Bay, Inc.

- Northern District of California.
- Decided February 11, 2015.
- Under the policy, the insurer had the right to appoint counsel of its choosing and did not abuse that right or otherwise breach a duty under the policy by appointing counsel that had conflicts with defendants –additional insureds under the policy.
- The insurer had a right to settle claims against its insured without defendants’ participation; the settlement is not improper merely because it only settles claims against insurer’s insured because there is no evidence that insured furthered its own interest or that defendants incurred increased defense fees or costs due to insurer’s settlement and subsequent withdrawal from litigation.



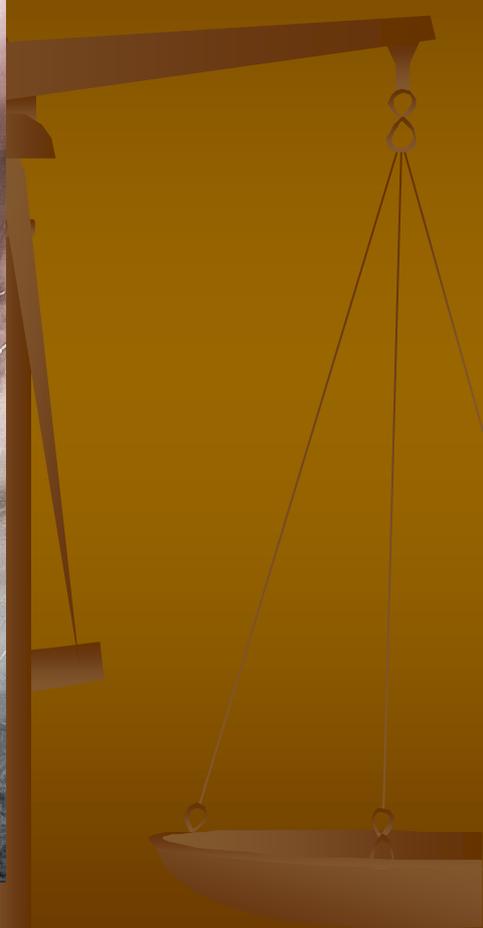
Catastrophe Coverage 2015

Risk is greater than we perceive



First Party Catastrophic Coverage

- Flooding is most common catastrophe in the US and accounts for 90% of all catastrophic loss.
 - Hurricane Katrina and Sandy alone caused \$160 billion in damage
- Only 10% of Katrina victims had flood insurance. Roughly 50% of Sandy victims had insurance. Nationwide, 7% of homeowners have flood insurance.



The US Poses Real Natural Disaster

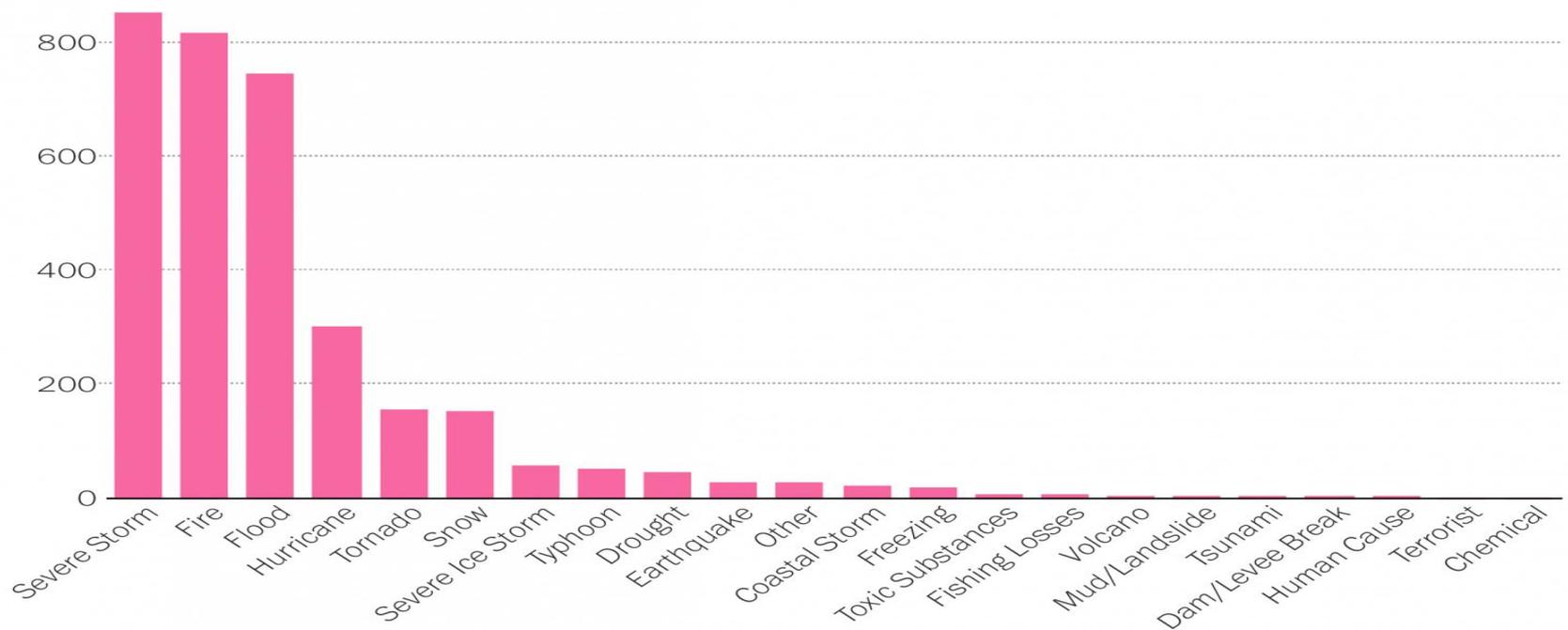
- Americans live in the most severe weather-prone country on Earth. Each year, face the following intense storms:
- 100,000 thunderstorms
- 10,000 severe thunderstorms
- 5,000 floods or flash floods
- 1,000 tornadoes
- 2 landfalling deadly hurricanes (NOAA)



The US Risk

The disasters that strike again and again

Number of disaster declarations by incident type, 1953 to 2014



WASHINGTONPOST.COM/**WONKBLOG**

Source: Federal Emergency Management Agency

Why Casino's Make Money

- We underestimate risk—the gambler's fallacy. The mistaken belief that past performance is a predictor of future risk. If there was a bad disaster last year, then there cannot be one this year too.
- We chose based upon experience. If not real catastrophes have occurred, we don't believe in over-protection because it's unnecessary.

Types of Catastrophic Coverage

- A “named peril” policy: loss must be identified as a covered peril in the policy.
- An “all-risk” policy: presumption that all losses are covered unless a specific exclusion in the policy precludes coverage.

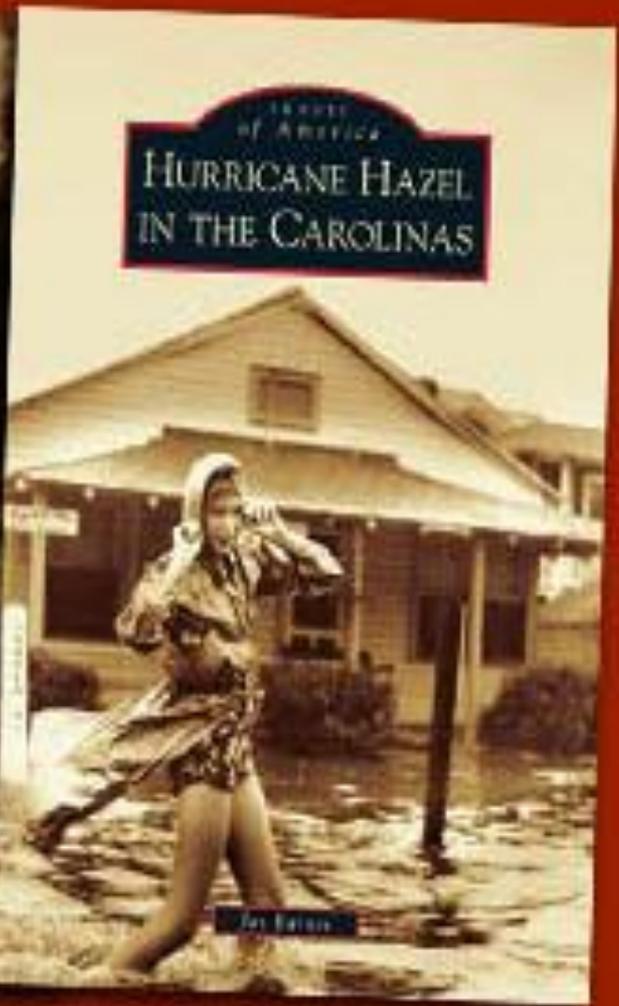
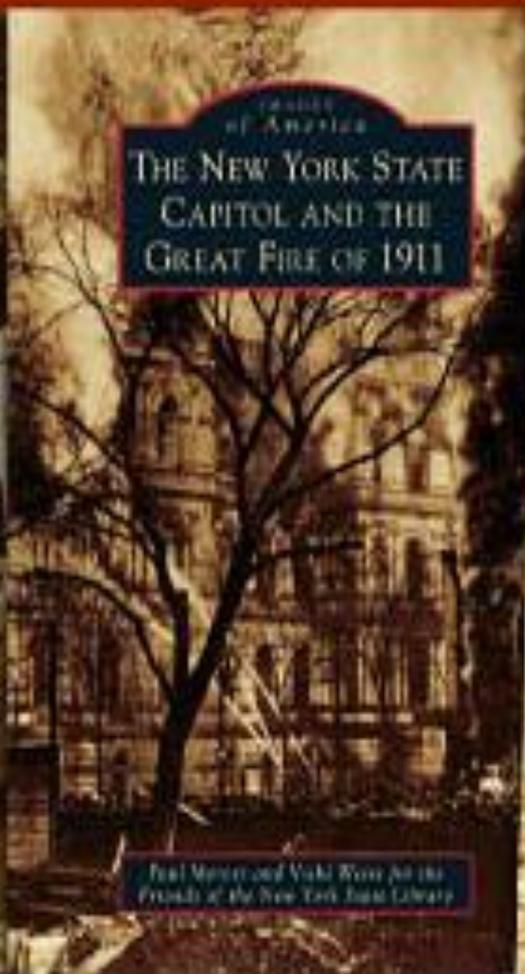
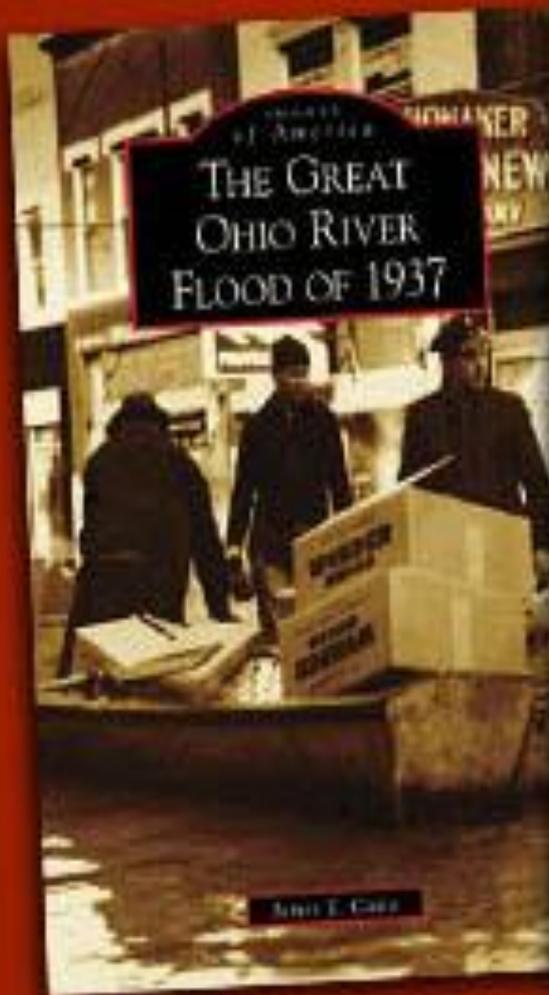


What to do?

- Plan. But remember, we are good at doing, not at planning.
 - Too often policyholder counsel face a political imbalance within the corporation.
 - Those who challenge the system face ostracism
 - Outsiders are expensive
 - Company wants to hear that it's doing the right thing already. Not that there are problems.

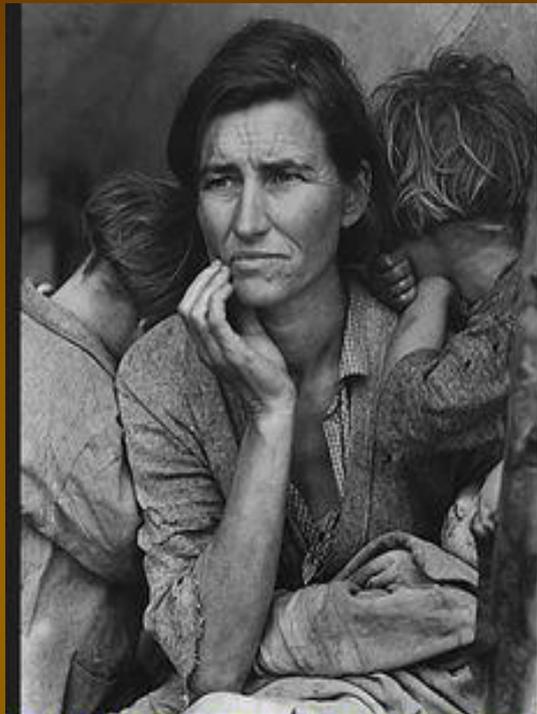
Some Helpful Suggestions

- Get the personal home address and phone number as well as private email for every broker. You may need it to give notice if the brokerage office is out too.
- Give notice immediately. Not after correcting the problem. Not while correcting the problem. Immediately.
ALL LAYERS.
- Retain a consultant to keep track of costs.



More Helpful Suggestions

- Bring in outsiders to help plan—the insiders built the plan so someone independent needs to challenge assumptions
- Keep your emergency documents in several places
- Consider (a) ingress/egress, (b) breach of K claims, (c) ability to continue, etc.



**9 Ways to Prepare
Your Family for
CATASTROPHES,
NATURAL DISASTERS, INCOME LOSS,
& ECONOMIC DEPRESSIONS.**
LiveLikeYouAreRich.com

Catastrophic Claim Submission is a Process

- Analyze basis for coverage with client and damages consultants before submitting the Proof of Loss. Pay attention to sublimits and cause of loss. Reserve right to supplement your Proof of Loss with additional loss and information.
- After submitting the claim, coordinate with contractors to invoice work accurately in line with available coverage.

Contracting Away Risk

- Key terms can be negotiated or modified:
 - Act of God
 - Concurrent Causation
 - Nuclear exclusion
 - Cost of rebuilding/relocating
 - Pollution exclusion
 - Occurrence (counting) definition
 - Choice of law
 - Dispute resolution provision

Cause of Loss Questions

- Most states apply the Efficient Proximate Cause, but there is no consensus on the meaning of “proximate cause”
 - predominant cause?
 - prime cause?
 - moving cause?
 - efficient cause?
 - common sense cause?



Enhanced Coverages to Consider

- Business interruption
- Contingent business interruption
- Contingent expense
- Legal Expense Insurance (LEI)
- Claims preparation coverage
- Civil authority coverage
- Service interruption coverage
- Ingress and Egress



Last Thoughts

- Provide notice—all layers. IMMEDIATELY
- Document all costs
- Litigation is a tool—use it. Pick the forum for the fight.
- Lean on your broker. They are “experts” and were to have helped you avoid risk.

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Breaking Bad Behavior: Recent Developments in Insurance Bad Faith Law

We are the ones who knock

- **Stephen Pate**, Norton Rose Fulbright US LLP
- **Mary McCutcheon**, Farella Braun + Martel LLP
- **Lewis Collins**, Butler Pappas
- **Alan Van Etten**, Deeley King Pang and Van Etten



First Party Policyholder Cases

New Jersey

- *AIG Cas. Co. of New York, Inc. v. Walsh*, 2014 WL 537481 (N.J. Super. Ct. App. Div. 2014)
 - 44' Yacht
 - All risk policy for physical loss or damage to the Yacht
 - Engine damaged
 - Insured double-recovered from insurer and engine manufacturer
 - Insurer pursued insured for return of its payment, including filing of suit
 - Insured counterclaimed for, *inter alia*, bad faith, alleging that AIG “badgered them excessively for return of the monies.”
 - Held that, because AIG had “absolute right” to demand return of claims payments, insurer failed to establish the requisite lack of legal basis to deny the claim (*i.e.*, to demand return of the claims payment).

New York

- *JD & K Associates, LLC v. Selective Insurance Group, Inc.*, 118 A.D.3d 1402 (N.Y. App. Div. 2014)
 - Commercial Property Insurance covering commercial building
 - Two large depressions appeared in the concrete slab floor
 - Claim denied under, *inter alia*, the earth movement exclusion, and based upon a certain “Investigative Engineering Analysis Report” by a Peter Vallas Associates (“Vallas”)
 - Insured claimed bad faith, alleging that the Vallas employee that completed the report upon which the coverage decision was based was not an engineer, and that insurer misrepresented his credentials to plaintiff
 - Held that insurer’s action did not amount to bad faith as a matter of law
 - Bad faith requires showing of “gross disregard of the insured’s interests”

Alabama

- *Jones v. Alfa Mut. Ins. Co., 1 So. 3d 23, 31 (Ala. 2008)*
 - House, garage, barn damaged by Hurricane Opal, including cracks to drywall, mortar of exterior brick, loose bricks in veneer, tree partially uprooted and fell into and damaged roof of house, metal truss in barn bent
 - Insurer obtained engineering report, which concluded that cracks were due to settling, not hurricane.
 - Question of material fact existed as to abnormal bad faith:
 - After Hurricane Opal, insurer *never* investigated any records it had of the condition of the insureds' house before the hurricane.
 - Insurer *never* contacted a realtor who visited the insureds' house three days before Hurricane Opal made landfall.
 - Insurer *never* attempted to interview anyone who may have visited the insureds' house before Hurricane Opal.
 - Insurer *never* considered its own "rewrite" inspection of the insureds' house and *never* inquired of Sanders, its own employee, as to the condition of the Joneses' house when he conducted the "rewrite" inspection....

California Cases

- *Jordan v. Allstate Ins. Co.*, 148 Cal. App. 4 1062, 1066, 56 Cal. Rptr. 3d 312, 314 (2007), *as modified on denial of reh'g* (Apr. 20, 2007)
 - Policy contained wet and dry rot exclusion and collapse exclusion
 - Insured discovered that a window had fallen out of the wall and the floorboards in the same room were “giving way”
 - Insured hired wood preservationist to conduct investigation and he concluded that damage was caused by a “water conducting fungus”
 - Insured submitted a claim along with the report to Allstate
 - Allstate denied coverage based on wet or dry rot exclusion
 - Insured sued for coverage declaration and bad faith arguing that the exclusion did not apply, and even if it did, the collapse exception within the collapse exclusion provided coverage
 - Allstate moved for summary judgment

California Cases

- *Jordan v. Allstate Ins. Co.*, 148 Cal. App. 4 1062, 1066, 56 Cal. Rptr. 3d 312, 314 (2007), *as modified on denial of reh'g* (Apr. 20, 2007)
 - Trial court granted summary judgment
 - Insurer appealed in *Jordan I*
 - Appellate court determined both insured's and Allstate's interpretations of the collapse provision were reasonable, and therefore, the provision was ambiguous
 - Upon remand, Allstate moved for summary judgment on both the coverage and bad faith claims
 - Trial court denied coverage summary judgment as there were triable issues of fact on the collapse issue
 - Trial court granted bad faith summary judgment based on Allstate's argument that its interpretation of the policy had been reasonable

California Cases

- *Jordan v. Allstate Ins. Co.*, 148 Cal. App. 4 1062, 1066, 56 Cal. Rptr. 3d 312, 314 (2007), *as modified on denial of reh'g* (Apr. 20, 2007)
 - Insurer appealed in Jordan II, the case under consideration
 - Appellate court held that while Allstate's interpretation of the wet and dry rot exclusion was reasonable, it still had a duty to investigate all possible bases of the insured's claim, including the collapse coverage
 - Appellate court then looked at insured's claims regarding Allstate's investigation to determine if there was a triable issue of fact as to Allstate's investigation
 - Appellate court held the factual issues were sufficient to defeat summary judgment on bad faith claim and reversed and remanded summary judgment in favor of Allstate

First Party Property Cases- Defense Side

Badiali v. New Jersey Manufacturers Insurance Group, 220 N.J. 544 (2015)

- Factual and Procedural Background:
 - Augustine Badiali was injured when he was struck in the rear by an uninsured motorist.
 - Badiali filed an uninsured motorist claim against his insurer, New Jersey Manufacturers Insurance Group (NJM).
 - The claim proceeded to arbitration, and the arbitration panel ruled in favor of Badiali.
 - NJM refused to pay, and Badiali sued NJM.
 - Badiali later filed a lawsuit, alleging that NJM operated in bad faith by arguing that the insurance policy permitted it to refrain from paying the arbitration award.
 - The trial court granted summary judgment in favor of NJM, reasoning that NJM’s interpretation of the insurance policy satisfied the “fairly debatable” standard.
 - The Appellate Division affirmed the trial court, concluding that one of its unpublished decisions supported NJM’s interpretation.

Badiali v. New Jersey Manufacturers Insurance Group, 220 N.J. 544 (2015)

- New Jersey Supreme Court:
 - As a matter of first impression, the Court held that the unpublished opinion provided a sufficient basis for avoiding a bad faith claim.
 - However, the Court limited its holding to the facts currently before the case.
 - According to the Court, corporations can rely on unpublished opinions in which they have been involved.
 - In addition, the Court noted that the insurance policy also provided NJM with a reasonable basis for refusing to pay the arbitration award.

Citizens Property Ins. Corp. v. Perdido Sun Condominium Ass'n, Inc., No. SC14-185, 2015 WL 2236719 (Fla. May 14, 2015)

- Factual and Procedural Background:
 - After Perdido Sun Condominium Association's (Perdido) property was damaged during a hurricane, Perdido filed a claim with Citizens Property Insurance Corporation (Citizens).
 - Perdido sued Citizens for breach of contract once Citizens paid an amount lower than the amount requested by Perdido.
 - The circuit court ruled in favor of Perdido.
 - Thereafter, Perdido sued Citizens, alleging that Citizens committed bad faith by refusing to settle Perdido's claims.
 - Citizens is an insurer created by the state legislature to provide affordable property insurance who in good faith cannot obtain insurance but are entitled to it.
 - The circuit court dismissed Perdido's claims, concluding that Citizens was entitled to immunity
 - The district court of appeal concluded that the willful tort exception applied and Citizens was therefore not entitled to immunity from suit

Citizens Property Ins. Corp. v. Perdido Sun Condominium Ass'n, Inc., No. SC14-185, 2015 WL 2236719 (Fla. May 14, 2015)

- Florida Supreme Court:
 - Citizens is immune from statutory first-party bad faith claims.
 - Citizens has a duty to handle claims in good faith, but statutory first-party bad faith claims are not included in the list of exceptions to Citizens's immunity
 - First-party bad faith claims are not willful torts because the cause of action was created by statute

Bannon v. Allstate Ins. Co., 2015 WL 778828 (N.J. Dist. Feb. 24, 2015)

- Factual and Procedural Background:

- Susanne Bannon's home was destroyed by Hurricane Sandy.
- An adjuster reviewed Bannon's claim and concluded that the damage was the result of wind damage.
- Later, Allstate denied Bannon's claim.
- Bannon sued Allstate, alleging that Allstate wrongfully denied to cover the damage and underpaid her for the damage of her home.
- Bannon alleged breach of contract, bad faith, and violation of the New Jersey Consumer Fraud Act.
- Allstate filed a motion to dismiss Bannon's claims for bad faith and violation of the New Jersey Consumer Fraud Act.
- Allstate also moved to dismiss Bannon's request for punitive damages and attorney's fees.



Bannon v. Allstate Ins. Co., 2015 WL 778828 (N.J. Dist. Feb. 24, 2015)

- U.S. District Court for New Jersey:
 - The district court granted Allstate’s motion to dismiss Bannon’s claims for punitive damages and attorney’s fees for the bad faith claim.
 - The court concluded that Bannon alleged sufficient facts to withstand Allstate’s motion to dismiss.
 - Specifically, the court pointed to Bannon’s allegations that
 - An Allstate adjuster initially concluded that the damage to Bannon’s home was caused by wind and
 - That Allstate did not send an engineer to inspect Bannon’s home until after it denied coverage.
 - The court held that New Jersey did not permit an insured to recover attorney fees in a “direct suit against [an] insurer to enforce direct coverage.”



Cammarata v. State Farm Florida Ins. Co., 152 So. 3d 606 (Fla. Dist. Ct. App. 2014)

- Factual and Procedural Background:
 - Joseph and Judy Cammarata’s home was damaged during Hurricane Wilma.
 - State Farm reviewed the claim and determined that the Cammaratas were not entitled to any payment.
 - A neutral umpire concluded that the Cammaratas were entitled to a payment under the policy. Subsequently, State Farm paid the Cammaratas.
 - The Cammaratas proceeded to sue State Farm, alleging bad faith failure to settle their claim.
 - State Farm moved for summary judgment on the Cammaratas’ claim, which the circuit court granted.
- Florida Fourth District Court of Appeal:
 - The Court held that an insurer’s liability for coverage and the amount of damages must be decided before a bad faith cause of action is ripe.
 - However, the Court reasoned that an insurer’s liability for breach of contract need not be decided before alleging a bad faith cause of action.

Third Party Liability Cases

Allstate Property and Casualty Insurance Company v. Wolfe, 105 A. 3d 1181 (Pa. 2014)

- Factual Background and Procedural History:
 - While in his vehicle, Jared Wolfe was struck from behind by Karl Zierle.
 - Wolfe refused Zierle's insurer's, Allstate, offer and filed a personal injury lawsuit against Zierle.
 - While Allstate paid compensatory damages, it refused to pay punitive damages award.
 - Wolfe agreed to forgo executing on punitive damages award if Zierle would assign any claims he may have against Allstate.
 - Wolfe then filed suit against Allstate, alleging that Allstate acted in bad faith by failing to settle Wolfe's lawsuit against Zierle.
 - The Third Circuit certified the following question to the Pennsylvania Supreme Court: whether Pennsylvania law permits an insured to assign the right to recover damages arising from a bad faith claim.
- Ruling:
 - The Pennsylvania Supreme Court held that Section 8371 permits an insured to assign a bad faith claim to an injured plaintiff and judgment creditor.

Cox. v. Cont'l Cas. Co., 2014 WL 2011238 (W.D. Wash. May 16, 2014)

- Factual Background and Procedural History:
 - Insured dentist faced multiple medical malpractice claims.
 - Insurer settled claims sequentially rather than acting upon Plaintiffs' counsel's suggestion that it tender policy limits towards a global settlement.
 - Four years later remaining Plaintiffs (including Cox) refused tender of remaining limits.
 - Remaining Plaintiffs secured \$35 million excess judgment.
 - Insured paid a portion from personal assets, assigned remaining claims to Plaintiffs.

Cox. v. Cont'l Cas. Co., 2014 WL 2011238 (W.D. Wash. May 16, 2014) (cont'd)

- Continental filed an interpleader of remaining limits, sought declaratory relief.
- Continental moved to dismiss and sought discovery of privileged communications re Plaintiffs' willingness to settle.
- Ruling:
 - District Court ruled that bad faith claim does not require “unmistakable opportunity” to settle within limits.
 - Sufficient (to withstand MTD) to allege that “receptive climate for settlement” existed.
 - Whether Plaintiffs would have settled is question for jury.

Everest Indem. Ins. Co. v. QBE Ins. Corp., 980 F. Supp. 2d 1273 (W.D. Wash. 2013)

- Factual Background and Procedural History:
 - Everest sued QBE for failure to defend mutual insured.
 - Everest moved to compel deposition testimony of QBE's coverage attorney.
- Ruling:
 - Court held that an insurer sued for bad faith must overcome presumption that claims adjustment communications by attorney are *not* subject to attorney-client privilege and work product protection.
 - Discovery may be taken concerning reasonableness of investigation and coverage determination.
 - The Court applied the rules in first-party cases to third-party case.

McMillin Cos. v. American Safety Indem. Co., 233 Cal. App. 4th 518 (Cal. Ct. App. 2015)

- Factual Background and Procedural History:
 - ASIC denied contractor's tender of defense in construction defect claim.
 - Contractor settled with all other insurers; proceeds exceeded defense costs.
 - Insurer filed motion in limine to preclude contractor from arguing that settlement proceeds were not an offset to damages for breach of duty to defend.
 - Court held that an offset from settlement proceeds paid by other insurers may affect an insured's right to recover contract damages, but insured was nevertheless entitled to present evidence of those damages in support of bad faith claim for tort damages.

Miller v. Kenny, 180 Wash. App. 772 (2014)

- Driver involved in accident which injured three passengers
- Safeco offered \$500,000 primary limits, but not \$1 million umbrella limits.
- Driver settled with passengers for full policy limits plus assignment in exchange for covenant not to execute.
- In ensuing bad faith action, passengers moved for partial summary judgment.
- Court held that the amount of a reasonable covenant judgment sets the floor for damages in a bad faith case.
- Plaintiffs could recover driver's additional damages (e.g. attorney fees, damage to credit, impact on insurability, emotional distress).

Piedmont Office Realty Trust, Inc. v. XL Specialty Ins. Co., No. S15Q0418 (Ga. 2015)

- Factual Background and Procedural History:
 - Piedmont sued in securities class action suit.
 - First MSJ denied, renewed MSJ granted years later.
 - While on appeal, Plaintiffs and Piedmont agreed to mediate.
 - Primary exhausted, \$4 million of excess (XL) spent on defense costs.
 - XL only agreed to fund \$1 million towards proposed \$6 million settlement.
- Ruling:
 - Court held that an insured may not settle without insurer's consent even if insurer acted in bad faith in refusing to consent to the settlement.

Piedmont Office Realty Trust, Inc. v. XL Specialty Ins. Co., No. S15Q0418 (Ga. 2015) (cont'd)

- Ruling (cont'd):
 - Court relied on prior GA authority interpreting “voluntary payments,” “no action” and “legal obligated to pay” policy conditions.
 - Policy provision that insurer XL could not “unreasonably” withhold consent did not matter.
 - Fact that District Court approved settlement irrelevant.
 - XL did not abandon insured (continued to fund defense) so not estopped from relying on consent provision.

Scottsdale Ins. Co. v. Addison Ins. Co., 448 S.W.3d 818 (Mo. 2014)

- Truck driver involved in auto fatality
- Addison primary - \$1 million; Scottsdale umbrella - \$2 million.
- Addison delayed settlement discussions, refused to offer policy limits.
- After wrongful death action filed, case settled for \$2 million.
- Addison filed motion for MSJ, claiming no bad faith because it ultimately tendered its \$1 million limits and insured did not suffer excess judgment.
- MSJ reversed: an insurer's ultimate settlement for policy limits does not negate insurer's earlier bad faith refusal to settle.

Scottsdale Ins. Co. v. Indian Harbor Ins. Co., 994 F. Supp. 2d 438 (S.D.N.Y. 2014)

- Factual Background and Procedural History:
 - Construction worker injured on site, sued owner.
 - \$1 million primary (Indian Harbor), \$10 million excess (Scottsdale).
 - Plaintiff moved for MSJ on liability and demanded \$2 million.
 - MSJ granted, demand renewed but “room for movement”.
 - At mediation, Plaintiff indicated would accept \$1 or \$1.2 million; Indian Harbor’s highest offer was \$250,000 (despite internal evaluation of \$950,000).
 - Case settled on eve of trial for \$2.5 million.
 - Scottsdale sued Indian Harbor for \$1.5 million, parties cross-moved for MSJ.

Scottsdale Ins. Co. v. Indian Harbor Ins. Co., 994 F. Supp. 2d 438 (S.D.N.Y. 2014) (cont'd)

- Ruling
 - Motions denied. The Court held that a primary insurer owes a duty to excess insurer to act in good faith in deciding to settle a claim if 1) the primary insurer exhibited “gross disregard” for the interests of the excess insurer; and 2) that “gross disregard” caused loss of actual opportunity to settle case within primary policy limits.
 - However, question of whether Indian Harbor’s “gross disregard” caused lost settlement opportunity is question for the jury.

Third Party Liability Defense Cases

Reasonable Opportunity to Accept?

Vanderhall v. State Farm Mut. Auto. Ins. Co., No. CIV.A. 4:14-518, 2015 WL 1507838 (D.S.C. Mar. 30, 2015)

- Bad accident, clear liability (car vs. bicycle)
- Injured Plaintiff in hospital & unconscious (23 yrs)
- Mom contacts lawyer
- Demand for \$25k policy limits
- Policy limits offered with conditions
- No mirror of terms – offer rejected

Reasonable Opportunity to Accept?

- Ct: State Farm's tender was a counter-offer
- Ct: no BF as a matter of law because:
 - Plaintiff was unconscious; and,
 - Mom who signed the retainer lacked legal authority to do so
- Ct.: even if the demand was valid, no BF
- Ok to tender PL with “the typical” settlement and covenant language
- No BF for doing so
- Contra: *Berges v. Infinity* (FL)



***Vanderhall v. State Farm Mut. Auto. Ins. Co.*, No. CIV.A. 4:14-518, 2015 WL 1507838 (D.S.C. Mar. 30, 2015)**

We Have Our Standards!

Franklin v. Nat'l Gen. Assur. Co., No. 2:13-CV-103-WKW, 2015 WL 350633 (M.D. Ala. Jan. 23, 2015)

- Ins. Co.: proper standard is “arguable-reason” test
- Based on facts Ins. Co. contended it had an arguable-reason in not settling claim
- Ins Co.: Plaintiff must show “the absence of an arguable or debatable reason” for refusal of pre-suit offer to settle
- Alabama law uses this test in 1st party cases
- Test is: Did ins. co. act in bad faith in the exercise of its settlement authority based on all of the facts and circumstances presented
- Totality of the circumstances test w/arguable reason a factor
- Therefore there were genuine issues of material fact precluding SJ

Not So Fast My Friend!



Hollaway v. Direct Gen. Ins. Co. of Mississippi, No. 2013-CA 000928-MR, 2014 WL 5064649, --- S.W.3d --- (Ky. Ct. App. Oct. 10, 2014), *reh'g denied* (Dec. 2, 2014)

- Test: Was liability for paying claim “beyond dispute”?
- Ct: Because the insurer’s liability for the BI claim was “not beyond dispute”:
 - No BF for failure to investigate and settle
 - SJ granted

Let Me Add My 2 Cents

Abbey/Land LLC v. Interstate Mech., Inc., 2015 MT 77, 378 Mont. 372, 345 P.3d 1032 (Mont. March 10, 2015)

- Insured tendered claim to liability carrier
- Liability carrier denied defense & indemnity
- Insured entered into a \$12 mil. confessed judgment
- Ins. Co. sought to intervene to contest reasonableness
- Trial ct. denied motion to intervene



Let Me Add My 2 Cents

Abbey/Land LLC v. Interstate Mech., Inc., 2015 MT 77, 378 Mont. 372, 345 P.3d 1032 (Mont. March 10, 2015)

- Denial of defense & indemnity allows stip. judgment
- Insurer must prove unreasonable
- Because insurer can challenge (and must prove) it has interest in action
- Stip. judgment will, in future be enforced against ins. co.
- Refusal to intervene impairs ins. co's (future) interests
- Should not be forced to make arguments in future case
- Court: insurer was entitled to intervene in the action to contest and challenge the reasonableness of the parties' consent settlement agreement

What Do We Do?

Humana v Western Heritage, Case No.: 12-20123-MGC, Document 56 Entered on FLSD Docket 03/16/2015



- Ins. Co. settled case at mediation
- Humana Medicare Advantage PPO
- Humana at first said no lien
- Then asserted lien
- Ins. Co. tendered 2 checks
- Plaintiff objected
- Plaintiff filed motion to enforce
- Ct. order: no Humana on check
- Plaintiffs atty. to hold in trust

What Do We Do?

Humana v Western Heritage, Case No.: 12-20123-MGC, Document 56 Entered on FLSD Docket 03/16/2015

- Plaintiffs negotiated and failed
- Humana sues plaintiffs and atty. in USDC
- Humana dismisses
- Plaintiff sues Humana in state court
- State court determines proper repayment
- Humana sues Western Heritage
- SJ for Humana against Western Heritage x2
- What??????

BF Refusal to Settle?

- Demand for PL
- Medicare Part B (Gold Plus) lien
- Demand makes no mention of Humana
- Plaintiff's atty. has obligation to protect liens
- PL tendered
 - Add Humana to lien?
 - Count on Plaintiff 's lawyer to protect?
- What do you do?

In line with the Breaking Bad theme this panel would like to propose a new member.

A distinguished policyholder counsel at Covington and Burling and former Supreme Court Clerk

- His name: **Saul Goodman**
- That's right: **Better Call Saul**

SUCCESSFULLY RESOLVING CASES:

**MEDIATION AND LONDON
ARBITRATION TIPS FROM THE
EXPERTS**

**2015 ACCEC Annual Meeting
May 22, 2015**



MICHAEL COLLINS, Q.C.

Essex Court Chambers, London

Crandall, Hanscom & Collins P.A., Rockland,
Me.



JED MELNICK

Panelist at JAMS ADR, New York, NY

Managing Partner for Weinstein Melnick LLC



HON. LAYN R. PHILLIPS

Phillips ADR Enterprises, P.C.

Corona Del Mar, CA

SETTING THE STAGE

- How does a mediator avoid being surprised by a significant insurance coverage issue at a three-party mediation session?
 - Pre-mediation discussions with parties?
 - Written questions for parties?

INCLUDING COVERAGE ISSUES IN A THREE-PARTY MEDIATION

- Maintaining impartiality as to both policyholders (whom you may rarely see) and insurers (whom you'll likely see more frequently).
- The challenges of a mediator hearing policyholders' concerns about insurance coverage, while also hearing policyholders' defenses in the mediation with the plaintiffs.
- Does the involvement of off-shore insurers who can only attend through counsel create particular problems or pitfalls? If so, how can they be managed?

INCLUDING COVERAGE ISSUES IN A THREE-PARTY MEDIATION (cont.)

- When are separate mediation statements on insurance issues advisable? Not advisable?
- When are opening statements or joint sessions between the insureds and the insurers advisable? Not advisable?
- What are your preferences regarding mediation statements - length, content, exhibits, etc.?
- How can post-mediation communications and negotiations be managed, especially when multiple insurers are involved?

INCLUDING COVERAGE ISSUES IN A THREE-PARTY MEDIATION (cont.)

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RESOLVING COVERAGE ISSUES IN SEPARATE ARBITRATION

- Are arbitrations more cost efficient than declaratory judgment actions?
 - Bermuda v. US

- What is the typical length of time between commencement and decision?
 - Bermuda v. US

- Availability of advance rulings of law (akin to domestic summary judgment practice)?
 - Bermuda v. US

RESOLVING COVERAGE ISSUES IN SEPARATE ARBITRATION (cont.)

- Makeup of panels - QC's, lawyers, retired judges, academics.
 - Bermuda v. US

- Impartiality of arbitrators.
 - Bermuda v. US

- Typical discovery permitted by panel vs. agreement of parties.
 - Bermuda v. US

RESOLVING COVERAGE ISSUES IN SEPARATE ARBITRATION (cont.)

- In Bermuda arbitration, what are the differences between (and consequences of) the seat of arbitration vs the place of hearing.
- In Bermuda arbitration, how do the parties present NY law -- briefs vs. expert testimony?

CONFIDENTIALITY

- Does arbitration or mediation provide more confidentiality (specifically, protection from discovery by plaintiff in underlying liability suit) than a declaratory judgment action?
- Are there specific approaches that might ensure or strengthen confidentiality?
- In a three-party mediation, does the confidentiality of the mediation preclude testimony or other evidence of a plaintiffs' settlement demand and an insurer's rejection of same?

CONFIDENTIALITY (cont.)

- In a two-party coverage mediation, does the confidentiality of the mediation preclude testimony or other evidence of a mediator's settlement proposal and an insurer's rejection of same?
- Should issues like this be addressed in the agreement to mediate, or would that discourage mediation?



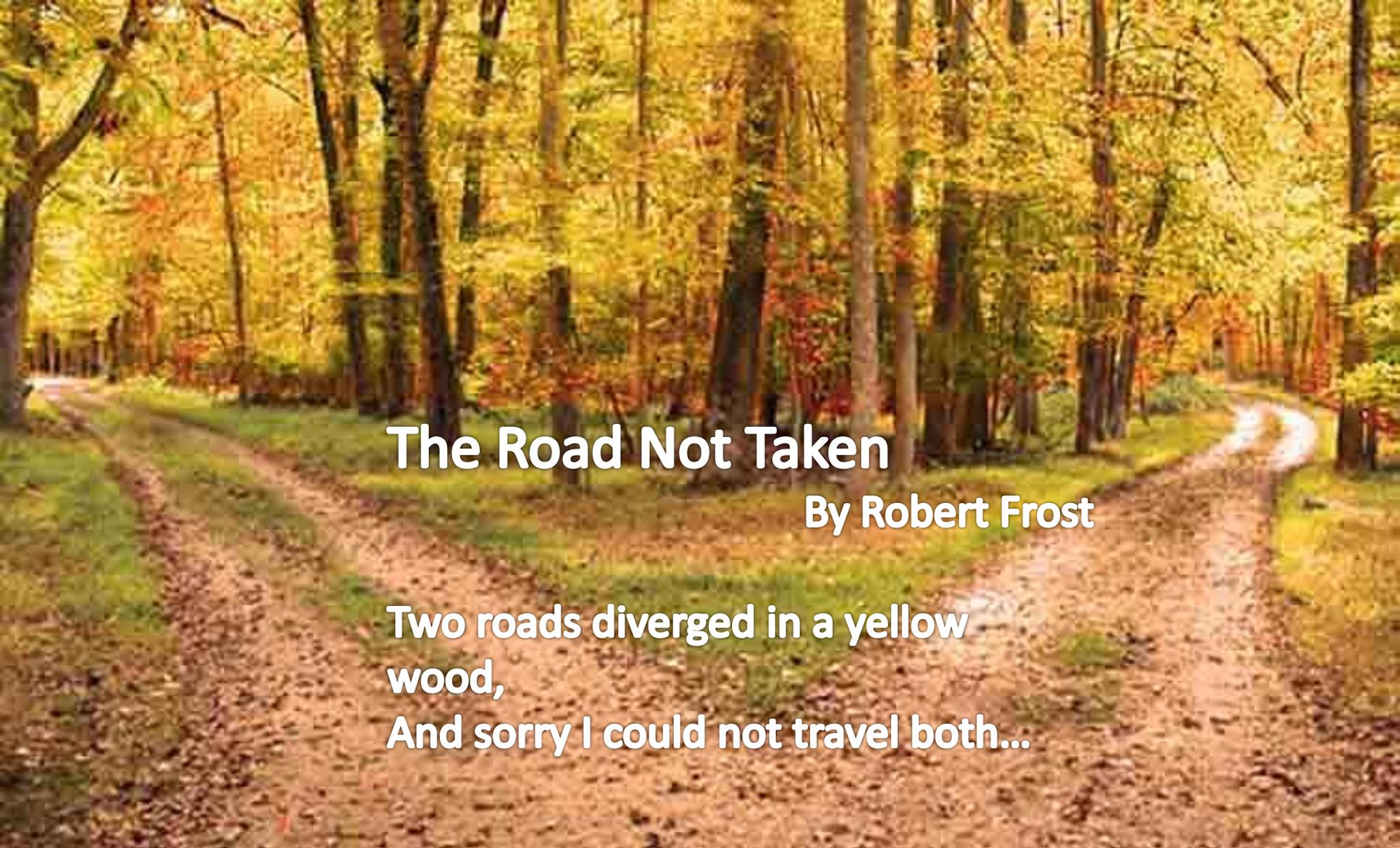


Insurer Intervention Into Underlying Lawsuit For Limited Purpose Of Helping Craft Interrogatories For Special Verdict Form

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The Road Not Taken

By Robert Frost

Two roads diverged in a yellow
wood,
And sorry I could not travel both...



Rule 24 Intervention

Intervention is the procedure by which some person or entity who is a stranger to a lawsuit, but who has an interest in the subject matter of lawsuit, may enter into that lawsuit as a party.



Rule 24 Intervention

- 1) Intervention of Right
- 2) Permissive Intervention
- 3) Notice & Pleading Required



Intervention of Right

On timely motion, the court must permit anyone to intervene who:

(1) is given an unconditional right to intervene by a federal statute; or

(2) claims an interest relating to the property or transaction that is the subject of the action, and is so situated that disposing of the action may as a practical matter impair or impede the movant's ability to protect its interest, unless existing parties adequately represent that interest.

Merits - Summary

1. File a timely motion
2. Claim an interest relating to the property or transaction at issue
3. Establish as a practical matter, that it may have an impaired or impeded ability to protect that interest
4. Establish that its interest is not adequately protected

Permissive Intervention

(1) On timely motion, the court may permit anyone to intervene who:

(A) is given a conditional right to intervene by a federal statute; or

(B) has a claim or defense that shares with the main action a common question of law or fact.

Permissive Intervention¹

(3) *Delay or Prejudice.* In exercising its discretion, the court must consider whether the intervention will unduly delay or prejudice the adjudication of the original parties' rights.

¹ Subsection 2 relates to government intervention.

Permissive Intervention

(c) **Notice and Pleading Required.** A motion to intervene must be served on the parties as provided in Rule 5. The motion must state the grounds for intervention and be accompanied by a pleading that sets out the claim or defense for which intervention is sought.

File A Timely Motion

1. Length of Time
2. Extent of Prejudice...failure to seek intervention
3. Extent of Prejudice...if application is denied
4. Unusual Circumstances

File A Timely Motion

Cooke V. Town Of Colorado City, Ariz.



Under both Rule 24(a) (intervention as of right) and Rule 24(b) (permissive intervention), court ruled Travelers motion to intervene was untimely.

The Road Not Taken

Does the insurer who issues a reservation of rights letter have a sufficient interest in underlying lawsuit to intervene as of right?

Restor-A-Dent Dental Labs v. Certified Alloy Products,
725 F.2d 871 (2nd Cir. 1984).



Restor-A-Dent

CGI insurer for defendant in products liability, breach of contract, and breach of warranty action moved to intervene under Federal Rules 24(a) or (b) to submit to the court proposed interrogatories on damages for the jury to answer.

Restor-A-Dent's Ruling

- (1) insurer could not intervene as of right since its interest in amount it would have to pay defendant under its policy did not qualify as interest in subject matter of action, and
- (2) district court did not abuse its discretion in denying permission to intervene.

The Path That Was Taken

For intervention as of right, interest in the transaction must be significantly protectable” and it must be “direct as opposed to contingent.”

Restor-A-Dent's Reasoning

- In denying the motion, the Second Circuit held that “[a]llowing the insurer to intervene even for limited purposes might, as a practical matter, deter a settlement and may well exacerbate a potential conflict of interest for the attorney furnished by [the insurer] to represent [the insured].”

Restor-A-Dent's Reasoning

- Moreover, [the insurer] failed to submit the disputed insurance policy to the district court ... [and] the policy would have enabled the court to determine whether 'there is a legitimate controversy' between the insurer and its insured or 'whether this is merely a tactical move' to affect settlement talks or the outcome of the action."

The Path That Was Not Taken

The court reached the above conclusions “fully aware that the precedents in support of the view are less than overwhelming.”



The Path That Was Not Taken

The court reached the above conclusions “fully aware that the precedents in support of the view are less than overwhelming.”

**Where the law is
uncertain,
There is no law.**

Proverb

Why One Path And Not The Other

Two factors unrelated to Rule 24...

1. Failure to attach a copy of the insurance policy
2. Conflict of interest



Courts That Travel The Restor-a-Dent Road

Travelers Indem. Co. v. Dingwell, 884 F.2d 629 (1st Cir. 1089)

Court held the insurers must claim an interest (2nd prong) to property or transaction, but the insurers' interest was only contingent because it reserved the right to deny coverage. The second claimed potential interest that there was no coverage, is not related to the subject matter of the action.

Morra v. Casey, 960 F.Supp.2d 335 (D. Mass. 2013)

Court granted permissive intervention to insurer's successor-in-interest. If the insurer later established that it must indemnify the insured, all or part of the jury's apportionment of damages may be relevant. Insurer proposed special verdict questions.

Nieto v. Kapoor, 61 F.Supp.2d 1177, 1193 (D.N.M. 1999)

Denied medical malpractice insurer's motion under 24(a) and (b) for jury instructions and interrogatories.



Courts On The Road Less Traveled

“Then took the other, as just as fair...”

Briggs & Stratton Corp. v. Concrete Sales & Services, Inc., 166 F.R.D. 43, 46 (M.D. Ga. 1996)

Granted motion to intervene under F.R.Civ.Proc. 24(a)(2) because (1) insurer had an obligation/financial burden to defend insured until a final determination is made about insured’s liability (insurer has legally protectable interest) and (2) insurer’s ability to protect its financial interest in the matter may be impaired by disposition of the action.

Fidelity Bankers Life Ins. Co. v. Wedco, Inc., 102 F.R.D. 41, 44 (D. Nev. 1984)

Insurer not entitled to intervention as a matter of right because disposition would not impair ability to protect themselves. Court allowed limited permissive intervention to proffer special interrogatories.

Thomas v. Henderson, 297 F.Supp.2d 1311 (S.D. Ala. 2003)

Permissive intervention granted on basis that submitting special jury interrogatories and/or a special verdict form would avoid the possibility of relitigation.

Summary

Probably Lose

Intervene as a right

Allowing the insurance company to intervene is the road less traveled

Better Shot of Winning

Permissive Intervention

Focus should be on need for specific interrogatory and/or special verdict form



Please be advised...

As with all of our webinars and seminars, it is not possible to cover every possible scenario. The information provided in this presentation is intended to serve as a guide to the discussion and should not be considered legal advice.



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