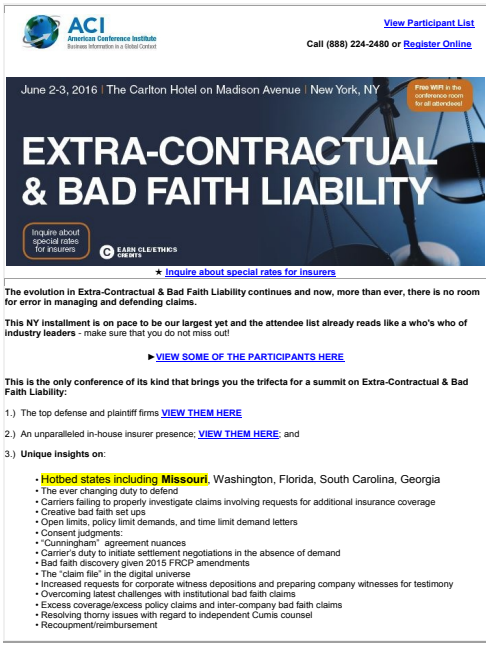
A Survey of Recent Developments in Coverage and Bad Faith Litigation



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The evolution in Extra-Contractual & Bad Faith Liability continues and now, more than ever, there is no room for error in managing and defending claims.

This NY installment is on pace to be our largest yet and the attendee list already reads like a who's who of industry leaders - make sure that you do not miss out!

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This is the only conference of its kind that brings you the trifecta for a summit on Extra-Contractual & Bad Faith Liability:

1.) The top defense and plaintiff firms VIEW THEM HERE

2.) An unparalleled in-house insurer presence; VIEW THEM HERE; and

3.) **Unique insights on**:

- Hotbed states including **Missouri**, Washington, Florida, South Carolina, Georgia
- The ever changing duty to defend
- Carriers failing to properly investigate claims involving requests for additional insurance coverage
- Creative bad faith set ups
- Open limits, policy limit demands, and time limit demand letters
- Consent judgments:
- "Cunningham" agreement nuances
- Carrier's duty to initiate settlement negotiations in the absence of demand
- Bad faith discovery given 2015 FRCP amendments
- The "claim file" in the digital universe
- Increased requests for corporate witness depositions and preparing company witnesses for testimony
- Overcoming latest challenges with institutional bad faith claims
- Excess coverage/excess policy claims and inter-company bad faith claims
- Resolving thorny issues with regard to independent Cumis counsel
- Recoupment/reimbursement

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RECENT MISSOURI BAD FAITH CASES

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Columbia Casualty Company v. HIAR Holdings

Missouri Supreme Court
August 13, 2013

Columbia Casualty Company v. HIAR Holdings

- Columbia Casualty refused to defend HIAR (its insured) in TCPA class action
- HIAR sued for sending 12,500 blast faxes in St. Louis
- HIAR twice tendered to Columbia
- Columbia denied defense because no "advertising injury" or "property damage"
- Class made policy limits ($1,000,000/$2,000,000) demand upon HIAR forwarded policy limits demand to Columbia
- Columbia refused to settle
- HIAR settles with class for $5,000,000
- HIAR assigns its claims against Columbia to class
- Class garnishes against Columbia

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Columbia Casualty Company v. HIAR Holdings

- Columbia files declaratory judgment action
  - Garnishment stayed
- DJ
  1. Columbia breached duty to defend HIAR

     Class claims covered under "advertising injury" and "property damage"
  2. Columbia breached duty to indemnify
  3. Columbia acted in "bad faith"
  4. $5,000,000 settlement "reasonable"

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Columbia Casualty Company v. HIAR Holdings

HIAR RULING:

- Plaintiff's Interpretation:
  - An insurer that wrongfully refuses to defend an insured is liable for judgment or settlement

    "The Insurer that wrongfully refuses to defend is liable for the underlying judgment as damages flowing from its breach of its duty to defend."
- Defendant's Interpretation:
  - Breach of the duty to defend results in liability for the cost of the settlement or judgment, up to the policy limits. Exposure beyond policy limits requires a showing of bad faith.

    "Because Columbia wrongfully denied coverage or even a defense under a Reservation of Rights, and also refused to engage in settlement negotiations, Columbia should not avoid liability for the settlement judgment entered in this case."

UNRESOLVED QUESTION:

- Does HIAR mean insurers who wrongfully denied a defense to insured are liable for entire amount of settlement or judgment absent a finding of bad faith?

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EXCESS CAN SUE PRIMARY FOR BAD FAITH FAILURE TO SETTLE

Scottsdale Insurance v. Addison Insurance, SC93792 (MO 2014)

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Scottsdale Insurance v. Addison Insurance, SC93792 (MO 2014)

- Facts
  - Primary v. Excess carrier case which recognized excess carrier's right to pursue primary carrier for bad faith failure to settle
  - The family of a motorist killed in a 2007 accident with a truck operated by Wells Trucking stated a claim against Wells Trucking
  - The state police investigation determined that the Wells Trucking driver was at fault
  - Wells Trucking's primary carrier ($1 million policy) was United Fire (Addison Ins. Co.)
  - Wells Trucking formally demanded that United Fire settle the case within the limits
  - There was evidence that the suit could have been settled within the primary limits
  - United Fire made several offers that Wells Trucking would later characterize as "low and unreasonable"

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Scottsdale Insurance v. Addison Insurance, SC93792 (MO 2014)

- Facts
  - The family grew frustrated and filed a wrongful death suit
  - The excess carrier, Scottsdale, was put on notice
  - Scottsdale demanded that United Fire attempt to settle within the primary limits "while it still had the opportunity to do so"
  - Shortly thereafter, the family made another demand of $1 million
  - United Fire rejected that demand and the family raised their demand to $3 million
  - The case resolved at mediation for $2 million; $1 million from United Fire, and $1 million from Scottsdale

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Scottsdale Insurance v. Addison Insurance, SC93792 (MO 2014)

- Facts
  - Wells Trucking assigned its rights to Scottsdale, and Scottsdale filed a bad faith action against United Fire
  - The trial court granted United Fire's motion for summary judgment:

"an excess insurer cannot recover from a primary insurer under a claim of bad faith refusal to settle and that bad faith refusal to settle could not be proven because United Fire settled the claim against Wells Trucking and paid its policy limits and Wells Trucking did not suffer an excess judgment."

Scottsdale Insurance v. Addison Insurance, SC93792 (MO 2014)

- Holding
  - On appeal, the Supreme Court of Missouri reversed holding that "an insurer's ultimate settlement for its policy limits does not negate the insurer's earlier bad faith refusal to settle and that an excess judgment is not essential to a bad faith refusal to settle action."
  - The excess carrier can establish a bad faith claim where the primary
    (1) Reserves the exclusive right to contest or settle any claim;
    (2) Prohibits the insured from voluntarily assuming any liability or settling any claims without consent; and
    (3) Is guilty of fraud or bad faith in refusing to settle a claim within the limits of the policy

American Family v. Parnell

Missouri Court of Appeals, Western District
October 27, 2015

American Family v. Parnell
Missouri Court of Appeals, Western District
October 27, 2015

- Parnell's operated a day care business
- Parnell's 11-year-old son had sexual contact with 7-year-old at day care
- Victim's family sues Parnell's for negligent supervision of victim
- Parnell's tender to American family for defense and indemnity
- American family files declaratory judgment action
  - Abuse exclusion – we don't cover for injury or damage resulting from sexual abuse
  - Intentional injury – we don't cover for injury or damage expected or intended by any insured
  - 11-year-old son an "insured" by definition

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American Family v. Parnell

- Holding:
  - Parnell's negligent supervision of victim was a "concurrent proximate cause" of victim's injuries. So, even if exclusions apply, Parnell's negligent supervision was a "separate and distinct cause" of her injuries for which coverage was provided.
- Key
  - do the "covered cause" and "excluded cause" depend upon each other to establish the necessary elements of each claim?
  - If "covered cause" could occur without the "excluded cause", then causes are independent and distinct and concurrent proximate cause rule applies.

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American Family v. Parnell

- **Conclusion**

Since claim for negligent supervision of a minor is unrelated to and can occur without intentional injury or sexual abuse, it is independent and distinct

- **Question**

Does concurrent proximate cause rule effectively void exclusions in policies?

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TRENDS ACROSS THE COUNTRY

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Breach of Duty to Defend Revisited

***K2 Investment Group, LLC v. American Guarantee & Liability*,6 N.E.3d 1117, 983 N.Y.S.2d 761 (Feb.18, 2014)**

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K2 Investment Group, LLC v. American Guarantee & Liability,6 N.E.3d 1117, 983 N.Y.S.2d 761 (Feb.18, 2014)

- Facts
  - Insurer allowed to assert policy defenses and summary judgment against insurer reversed based on the existence of a question of fact as to whether policy exclusion applied
  - Insurer wrongfully refused to defend insured
  - Insured's assignee argued that insurer could not rely on policy defenses to defeat liability or default judgment against insured
- Holding
  - In first K2 case, we held that an insurer who breached duty to defend may not assert defenses to immunity
  - First K2 case conflicted with another decision, *Servidone Constr. Corp. v. Security Ins. Co. of Hartford*, 64 N.Y.2d 419, 488 N.Y.S.2d 139, 477 N.E.2d 441 (1985)

K2 Investment Group, LLC v. American Guarantee & Liability,6 N.E.3d 1117, 983 N.Y.S.2d 761 (Feb.18, 2014)

- Holding
  - The court followed *Servidone*
  - Insurer allowed to assert policy defenses and summary judgment against insurer reversed based on the existence of a question of fact as to whether policy exclusion applied
  - NC law: Insurer who breaches duty to defend is estopped to deny coverage
  - Majority rule: follows *Servidone*

PRIORITY OF EXCESS/OCIP

***Certain Underwriters v. Illinois Nat. Ins. Co.*, No. 09 Civ. 04418**
(S.D.N.Y. March 13, 2015)

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***Certain Underwriters v. Illinois Nat. Ins. Co.*,No. 09 Civ. 04418**
(S.D.N.Y. March 13, 2015)

- Facts
  - Trucking accident on construction site
  - Two competing, virtually identical "other insurance" clauses
  - Policies incorporated into an Owner Controlled Insurance Program ("OCIP")
  - OCIP listed Underwriters' policy as an excess policy in the program
  - OCIP did not include coverage for truckers, drivers and haulers, including Continental's insured
  - Continental and UW policies both purported to be excess over other insurance

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***Certain Underwriters v. Illinois Nat. Ins. Co.*,No. 09 Civ. 04418 (S.D.N.Y. March 13, 2015)**

- Facts
  - Continental's argument that UW policy is excess over Continental policy because UW policy was issued per the OCIP which was …
    - a "contract" that "specifically requires that [the UW policy] be primary and contributory,"
    - thereby making the UW policy primary under an exception to the UW "Other Insurance" clause
- Holding
  - "Because OCIP constitutes neither an express nor an implied contract triggering that exception, both 'other insurance' clauses remain in effect and are mutually repugnant on their faces"
  - Both policies provide pro-rata excess coverage

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"OCCURRENCE" AND EXCLUSIONS IN A SEXUAL ASSAULT CASE

***Gonzalez v. Fire Ins. Exch., et al.,* 234 Cal.App.4th 1220 (2015)**

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***Gonzalez v. Fire Ins. Exch., et al.,* 234 Cal.App.4th 1220 (2015)**

- Facts
  - Gonzalez sued Rebagliati and nine other members of the De Anza College baseball team after a sexual assault
  - Rebagliati sought coverage under his parents' homeowner's (Fire Ins. Exch.) and personal umbrella (Truck Ins. Exch.) policies
  - Both denied coverage
  - Rebagliati settled and assigned rights to Gonzalez
  - Gonzalez alleged breach of contract and bad faith
  - Trial court granted insurers' motions for summary judgment
  - Gonzalez appealed

***Gonzalez v. Fire Ins. Exch., et al.,* 234 Cal.App.4th 1220 (2015)**

- Holding
  - Affirmed as to the primary policy; no occurrence
  - Reversed as to umbrella; the definition of "personal injuries" did not require the covered events to be "accidental"
  - Umbrella carrier also failed to meet burden of proof for several exclusions
  - Sexual molestation exclusion
    - No coverage if the insured participated, but pleading in the disjunctive ("and/or the other defendants") left open possibility that insured did not participate
    - Evidence learned post-tender of the claim is irrelevant to duty to defend; Rebagliati admitted to participation after insurers had already rejected the claim

***Gonzalez v. Fire Ins. Exch., et al.,* 234 Cal.App.4th 1220 (2015)**

- Expected or Intended exclusion
  - Exclusion for damages that are "[e]itherexpected or intended from the standpoint of the insured"
  - Rebagliati had denied participation at time of tender so he could have been liable for "damages incurred by Gonzalez due to his negligence in creating the conditions that led to her false imprisonment in the room."
  - "A tort such as false imprisonment may result from intentional conduct and is therefore nonaccidental, but a subjective intent or expectation that harm would occur on the part of the insured is not required for liability."
- Criminal Acts exclusion
  - No evidence that insured "consented to or ratified these acts"

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WORTH A MENTION

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EXPANDING THE "FOUR CORNERS" OF THE POLICY

***In re: Deepwater Horizon, Relator*, No. 13-0670 (TX 2015)**

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***In re: Deepwater Horizon, Relator*, No. 13-0670 (TX 2015)**

- Facts
  - Claims for environmental damage arising out of the April 2010 explosion and sinking of the *Deepwater Horizon* oil-drilling rig in the Gulf of Mexico
  - BP was the oil field developer
  - Transocean was the drilling rig own
  - Drilling Contract between Transocean and BP
  - Transocean agreed to indemnify BP for surface pollution
  - BP agreed to indemnify Transocean for subsurface pollution

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***In re: Deepwater Horizon, Relator*, No. 13-0670 (TX 2015)**

- Facts
  - Drilling Contract required Transocean to name BP as additional insured on primary GL and four layers of excess ($700 million in coverage)
  - Additional insured provision required AI status for "liabilities assumed by [Transocean] under the terms of this contract."
  - I.e., surface pollution but ***not*** subsurface pollution
  - Policies had an "Insured Contract" provision
  - Extended "Insured" to include any person "to whom the 'Insured' is obliged by oral or written 'Insured Contract' … to provide insurance such as afforded by [the] Policy."
  - No dispute that the Drilling Contract was an "Insured Contract"

***In re: Deepwater Horizon, Relator*, No. 13-0670 (TX 2015)**

- Facts
  - BP submitted a claim to Transocean's carriers
  - The insurers filed a declaratory judgment action: *In re Deepwater Horizon*, 2011 WL 5547259 (E.D. La. Nov. 15, 2011)
  - The insurers argued that BP was not entitled to coverage for the subsurface claims because of the Drilling Contract
  - BP argued that the policies themselves did not contain this limitation
  - The district court ruled in favor of the insurers –the terms of the Drilling Contract limited the coverage afforded by the policies
  - The Fifth Circuit reversed: coverage defined by the "four corners" of the policies
  - The question was certified to the Texas Supreme Court

***In re: Deepwater Horizon, Relator*, No. 13-0670 (TX 2015)**

- Holding
  - Two approaches:
  - 1. A policy may incorporate an external limit on additional insured coverage (citing *Urrutia v. Decker,* 992 S.W.2d 440 (Tex. 1999))
  - 2. "A named insured may gratuitously choose to secure more coverage for an additional insured than it is contractually required to provide." (citing *Evanston Ins. Co. v. ATOFINA Petrochemicals,*256 S.W. 3d 660 (Tex. 2008))
  - Under first approach, the insurers win
  - Under second approach, BP wins.

***In re: Deepwater Horizon, Relator*, No. 13-0670 (TX 2015)**

- Distinguished *ATOFINA*:

  The existence of a ***certificate of insurance*** naming ATOFINA as an additional insured meant that … there was no need to look to the underlying service contract to ascertain ATOFINA's status as [an additional insured.] Moreover, section III.B.6 of the policy in *ATOFINA* made ***no reference to the service contract in determining the scope of additional-insured coverage***, while the Transocean policies refer to an "Insured Contract" that requires Transocean to provide the insurance as a predicate to status as an "Insured."
- In other words, had there been a certificate of insurance saying BP was an AI and/or there was no "Insured Contract" provision, there would have been no need to look at the Drilling Contract

***In re: Deepwater Horizon, Relator*, No. 13-0670 (TX 2015)**

- "The language in the insurance policies providing additional-insured coverage 'where required' and as 'obliged' requires us to consult the Drilling Contract's additional-insured clause to determine whether the stated conditions exist. … [W]hen we do so, it becomes apparent that the only reasonable interpretation of that clause is that the parties did not intend for BP to be named as an additional insured for the subsurface pollution liabilities BP expressly assumed in the Drilling Contract."
- How is this unusual? Why was *ATOFINA* so different?

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INSURER CAN BE LIABLE FOR NEGLIGENCE IN CLAIM HANDLING

***Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. Dec. 2014)**

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***Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. Dec. 2014)**

- Facts
  - The Brunos bought a home in 2007 and obtained a homeowners' policy from Erie
  - The policy covered physical loss to the property caused by "fungi," included in a separate endorsement
  - Pursuant to the endorsement, Erie would be required to pay the Brunos up to $5,000 for a direct physical loss caused by mold
  - When the Brunos found black mold in their basement, they contacted Erie
  - Erie sent Rudick Forensic Engineering to investigate the mold problem
  - Rudick said the mold was harmless
  - The claim was not paid

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***Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. Dec. 2014)**

- Facts
  - The Brunos stayed in the house and found more mold growing on leaking pipes
  - They told Erie, who tested it, but did not disclose the results of the tests
  - The Bruno family suffered severe respiratory ailments
  - By January 2008, the Brunos decided to have the mold tested on their own
  - They discovered that the mold was toxic and hazardous to their health
  - They again asked Erie for the full mold benefit, and Erie made the $5,000 payment to the Brunos

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***Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. Dec. 2014)**

- Facts
  - The Brunos were forced to demolish their house
  - The wife, Angela Bruno, developed esophageal cancer as a result of exposure to the toxic mold
  - The Brunos filed a breach of contract and bad faith action that also included a negligence claim against Erie for its actions during the claim handling process, and the actions of its agent, Rudick
  - Erie filed preliminary objections as to the negligence claim based on the gist of the action doctrine
  - The trial court sustained the preliminary objections, and the intermediate appellate court affirmed

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***Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. Dec. 2014)**

- Holding
  - Reversed
  - "If the facts of a particular claim establish that the duty breached is one created by the parties by the terms of the contract (i.e., a specific promise to do something that a party would not ordinarily have been obligated to do, but for the existence of the contract), then the claim is to be viewed as one for breach of contract"
    - gist of the action applies
- "if, however, the facts establish that the claim involves the defendant's violation of a broader social duty owed to all individuals which is imposed by the law of torts and, hence, exists regardless of the contract, then it must be regarded as a tort"
    - gist of the action does ***not*** apply

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***Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. Dec. 2014)**

- Holding
  - An insurer can be liable for negligent acts undertaken during the claims handling process:

    "A negligence claim based on the actions of the contracting party in performing contractual obligations is not viewed as an action on the underlying contract itself, since it is not found on the breach of any specific executory promises that comprise the contract

    Instead, the contract is regarded merely as the vehicle or mechanism which established the relationship between the parties during which the tort of negligence was committed."
  - So, while Erie had contractual obligations under its policy to investigate whether mold was present and also pay for all property damage caused by the mold, the substance of the claim is that Erie's agents were negligent "***during the course of fulfilling these obligations***"

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DEFENSE TRENDS IN BAD FAITH LITIGATION

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Reservation of Rights

Erie Ins. Ex. v. Lobenthal, 2015 WL 1668183 (Pa. Super. 2015)

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Erie Ins. Ex. v. Lobenthal, 2015 WL 1668183 (Pa. Super. 2015)

- Facts
  - Plaintiffs injured in a car accident
  - Alleged that the additional insured —Ms. Lobenthal—was liable for the accident because she provided drugs and alcohol to the driver of the car
  - Erie sent a reservation of rights letter, and then a second 9 months later, to Ms. Lobenthal's parents and her attorney
  - Both letters only reserved the right to disclaim coverage against the parents, and made no mention of Ms. Lobenthal
  - In declaratory judgment action the trial court granted summary judgment to Erie ruling that Erie had no duty to defend or indemnify Lobenthal

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Erie Ins. Ex. v. Lobenthal, 2015 WL 1668183 (Pa. Super. 2015)

- Holding
  - The Court found no notice to Ms. Lobenthal
  - Erie first referenced the controlled substances exclusion in the policy in its second letter, sent more than seven months after the complaint was filed
  - Given the information available to Erie, the letter was untimely and the court ordered Erie to defend and indemnify Ms. Lobenthal
  - Erie's reservation of rights letter to an additional insured was ineffective where the letter was untimely and was not addressed to the additional insured herself, but rather to her parents (the named insureds) and her attorney
  - Erie was required to defend and indemnify the additional insured

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Reservation of Rights Letter

- Most states do not require insured to accept defense under ROR
- If insured rejects ROR, insurer's next decision can have significant consequences.
  - Withdraw reservation and defend outright
  - Withdraw defense
  - File a declaratory judgment action
    - Construed as denial of coverage

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Problem w/ Reservation of Rights

- Duty to defend is broader than duty to indemnify
- Duties to defend and indemnify are two separate and distinct duties under the policy
  - Courts are finding that breach of duty to defend creates liability for underlying judgment as damages flowing from the failure to defend
  - The NET effect is that duty to indemnify is just as broad as the duty to defend

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What is the Solution?

- Pick the lesser of two evils:
  - Weak tort liability, defend and indemnify
  - Strong coverage defenses, fight the good fight
- Unconditional defense
  - Letter recognizes two duties: defense & indemnity
  - Defense duty: determined by allegations in suit
  - Indemnity: determined based on case resolution
  - Concerns:
    - Same as ROR?
    - Strict ROR requirement

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What is the Solution?

- Unconditional defense with *Cumis* Counsel
  - Cumis counsel gives insured right to control litigation
  - Allows potential to create coverage at expense of insurer
- Suggestions?

Bad Faith Set Up Defense

- Missed opportunity to settle within policy limits
  - Arbitrary time constraints
    - Sudden death time table
    - Settlement conditioned on payment
  - Ambiguous demands
  - Premature demand
  - Settlements with unworkable conditions

Bad Faith Set Up Defense

- Recognize set up early
- Avoid delay, proceed quickly with requests for information
- Respond, but be reasonable
  - Your response is Exhibit A
- Keep insured informed AND involved

Reverse Bad Faith Claims

- Contract vs. Tort claim
  - Implied covenant of good faith and fair dealing
  - Duty to act in good faith imposed by common law
    - Generally requires special relationship

Reverse Bad Faith Claim

- Fraud or Collusion
  - Heightened burden: Clear and Convincing
  - Agreement between tortfeasor and insured should require heightened scruting
  - Offset the standards to require ordinary proof

Reverse Bad Faith Claim

- Unreasonableness
- Misrepresentation
- Concealment
- Secretiveness
- Lack of serious negotiations on damages
- Attempts to affect insurance coverage
- Profit to the insured
- Attempts to harm the interests of insurer

Questions?

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