

GAMES INSURERS PLAY: HOW INSURERS SEEK TO LIMIT POLICY BENEFITS THEY OWE TO THEIR POLICYHOLDERS

I. INTRODUCTION

Typical of the observations made by insurer claims managers in explaining why even covered claims should be routinely denied was an internal recommendation on how to proceed with an insurance claim made by a claims manager: “ ‘[L]ets [*sic*] bluff it out we can always buy out at a later date.’ ”¹

Insurers are in the business of earning sufficient investment income to offset losses they must ultimately pay out. The longer they defer obligations, the more revenue they can obtain. The only breaks on this behavior are threefold: **First**, bad faith law, often toothless in the majority of jurisdictions. **Second**, despite potential exposure for prejudgment interest, often as high as 12% in many jurisdictions, many policyholders are unwilling to pursue coverage claims because of the perceived cost of pursuing coverage litigation, especially where, in a number of forums, the cost to pursue the coverage is at the policyholder’s and not the insurer’s expense. **Third**, some desire to continue a business relationship with the policyholder.

II. WHY DO INSURERS ROUTINELY DENY A DEFENSE DUTY FOR COLORABLE COVERAGE CLAIMS

A. The Economics of Insurer Denials – The 1% Rule

Another explanation as to this conduct is the 1% rule. This is a variation on the notion that in most jurisdictions, if there is any potential for coverage (i.e., only 1% of the lawsuit is potentially covered), the whole suit must be defended in its entirety, at least initially. One would think the logic of this proposition would have insurers more readily conceding that defense

¹*Farris v. United States Fidelity & Guaranty Co.*, 284 Ore. 453, 455 (1978).

duties arise. That is often the case. However, insurers have turned this 1% rule on its head, instead adopting the 10% formula to reap gain. Pursuant to the insurer's version of the 10% rule – if only 1% of the claims are allowed, and even these on a reservation of rights basis – the 99% of the insureds who do not obtain policy benefits will be forced to ultimately litigate coverage issues in order to obtain policy benefits.

B. Why Do Companies Challenge Insurer Misbehavior?

First, based on the lack of internal expertise in many corporations regarding the true benefits available through policies, especially for atypical claims, such as those for a variety of business torts like intellectual property violations or antitrust claims, few insureds truly analyze and pursue all policy benefits.

Second, many insureds, concerned about renewal or heightened premium expense where a harder market prevails, will let claims that might otherwise be covered lay unpursued.

Third, brokers, some of whom may have a financial interest in lowering claims experience, will often render opinions that claims are in fact noncovered where they do not have the expertise nor, as a matter of law, the requisite license to counsel insureds on whether claims are potentially covered, and thus will recommend no pursuit of claims. This is especially troubling where the brokers are also agents of the insurers and, indeed, would not be permitted to deal with the insureds without an agency agreement in effect.

Finally, expertise in analyzing for IP and antitrust business torts requires not only knowledge of how liability will attach therein, but its connection to the pertinent policy language. This is an especially tricky proposition where new forms of coverage in professional liability and cyberspace as well as variant commercial liability coverages are at issue. Absent a full understanding of how courts have interpreted these policy provisions, as well as rounding

and rules of policy construction in the various forms whose law might apply therein, prognostications as to whether a claim is potentially covered or not are fraught with peril.

Carriers can, therefore, colorably argue that a claim may or may not be covered in a variety of situations where proper analysis would, at minimum, require a defense subject to reservation of rights. The practical result of this mix of factors is that often insurers in these areas will deny 99% of these kinds of claims initially or engage in a delayed investigation and may never acknowledge any defense duty.

C. What Should a Policyholder Do?

Those policyholders who initially write letters can be readily denied by simply citing a number of policy provisions and then ending with a conclusionary denial stating that there is no potential coverage because of these provisions. Should additional push-back from policyholders occur, opinions can then be expressed in denial letters. Again, without citation of authority, that particular language should only be understood in certain ways. Typically, these pronouncements fail to follow applicable rules of policy construction or misunderstand how liability will attach in the underlying suit. Where policyholders are particularly aggressive and hire outside coverage counsel, carriers can do the same and continue to disagree. Indeed, insurers often hire outside counsel who have stated that, absent a Supreme Court case opinion on point, they view the issue as unresolved and need not even defend under a reservation of rights, so long as they can create a colorable argument that some court within the applicable jurisdiction may adopt.

D. Why Insurers Continue Saying “No” to Coverage

If policyholders succeed in litigating a case, establishing a defense and even recovering their coverage fees, either by statute or case law in certain jurisdictions or through proving breach of the covenant of good faith and fair dealing, then those few instances of recovery will

still have saved the insurer significant monies. The only downside risk to the insurers is that negative precedent will be established if they lose critical coverage cases. They are, thus, reticent to pursue a claim to an appellate court level where they are unsure of their coverage position.

E. The Blast Fax (TCPA Violation) Example

Even this stratagem may not sway the insurers from trying to make new law which supports a narrow interpretation of coverage if it benefits their interests in denying claims. Thus, under the TCPA, sending a blast fax (i.e., unsolicited facsimile) can create liability for statutory damage of \$500 per person. Class actions around the country asserting such claims are rampant. Prior to December of 2004, 13 favorable district court and state court of appeal decisions existed, including a Fifth Circuit affirmance in nonpublished form of a district court case. Nevertheless, insurers in appealing a Seventh Circuit ruling were able to obtain a conservative reading of the scope of invasion of privacy coverage that limited it to secrecy, but not seclusion, i.e., right to be left alone claims.

In *American States Ins. Co. v. Capital Associates of Jackson County, Inc.*, 392 F. 3d 939 (7th Cir. (Ill) 2004), the court divined a distinction between the privacy torts of seclusion and secrecy finding that only secrecy claims implicated potential coverage despite conceding that “privacy” has many connotations. The court noted that a corporate plaintiff cannot have a true seclusion interest and extrapolated from these facts in interpreting the policy at issue. An earlier Illinois Chancery state court opinion, which *Capital Associates* failed to cite, followed the majority rule finding a duty to defend.² An Illinois trial court refused to follow *Capital*

²See *Acuity v. Superior Marketing System*, No. 02CH8643, 2003 WL 24004567 (Cir. Ct. Ill., Cook County, Chancery Div. May 30, 2003).

Associates finding it inconsistent with Illinois law as articulated by state courts.³ Other courts in the Tenth, Eleventh and Fourth Circuits,⁴ are reviewing issues and may respond negatively to the analysis therein. The Texas Supreme Court denied review in a matter where after its briefing surveyed on the insurer's pending motion for review.⁵ Nevertheless, American States was willing to challenge the district court's ruling, even though no colorable law supported its view.

Among appellate courts, the law is unsettled where the carriers often take hard-line positions which may ultimately cost them more money in the long run. However, that will be the responsibility of the next claims representative or insurance company president, so as not to impede their present course of action.

The practice point for policyholder counsel is to recognize that insurer denials should be taken with "a grain of salt." Where significant monies are at stake, independent coverage analysis should be performed and the economic benefits of obtaining policy benefits properly assessed. Policyholders should not assume that, simply because the carrier has denied a defense. Their analysis should be accorded any presumption of validity.

III. INSURER TECHNIQUES TO LIMIT POLICY BENEFITS IN BUSINESS TORT CASES

A. Insurers Who Urge That There Is No Potential Coverage for the Claim on a Variety of Grounds

1. Public Policy or Cal. Ins. Code § 533 Bars Any Potential Coverage Because the Only Conduct Alleged Is Willful Activity

Even if some allegations within a complaint assert willful conduct, it is unlikely that the only liability that claimants seek to attach is for conduct undertaken with a knowing intent to

³See *Transportation Ins. v. Striker Securities Inc.*, No. 04CH245 (Cir. Ct. Ill., Cook County February 10, 2005).

⁴*Park University Enters v. American Cas. Co.*, 314 F. Supp. 2d 1094, 1106-09 (D. Kan. 2004); *Hooters of Augusta, Inc. v. American Global Ins. Co.*, 272 F. Supp. 2d 1365, 1371-74 (S.D. Ga. 2003); *Resource Bankshares Corp. v. St. Paul Mercury Ins. Co.*, 323 F. Supp. 2d 709, 716-20 (E.D. Va. 2004).

⁵*TIG Ins. Co. v. Dallas Basketball, Ltd.*, 129 S.W.3d 232, 236-40 (Tex. App. - Dallas [5th Dist.] 2004).

injure or with the substantial probability that injury will result, thereby triggering California Insurance Code § 533 prohibitions.⁶ The willfulness claim will, however, typically give rise to a conflict of interest requiring the insured to pay for counsel appointed by the insurer at reasonable rates or, if proof under Civil Code § 2860 is provided, those paid to competent counsel to do similar work in the same community where the action arose.⁷

Moreover, in many situations there will be distinct liability for an employee charged with wrongful acts who may have acted beyond his authority as a corporate agent. In such an event, even if the employee's conduct would not be potentially covered, that of his corporate employer would be.⁸

2. If One Insured Is Barred from Coverage under the Policy, Then All Other Insureds Cannot Seek Benefits

Commercial liability policies, most professional liability policies and cyberspace Internet policies have some form of severability of interest or separation of insurance provisions. Their intent is to treat insured persons or entities as if the policy were separately issued to each. Thus, an exclusion will bar coverage for the alleged bad action, but may not have an adverse effect on other insureds under the policy.⁹

⁶*California Amplifier v. RLI Ins. Co.*, 94 Cal. App. 4th 102, 117 (2001) (“There must be a knowing and purposeful act that is intended to cause damage . . .”).

⁷*Zurich Ins. Co. v. Killer Music, Inc.*, 998 F.2d 674, 678-79 (9th Cir. (Cal.) 1993) (Because the insured's liability for copyright infringement could be based on intentional or nonintentional conduct, section 533 did not preclude the insurer from providing a defense.).

⁸*Fireman's Fund Ins. Co. v. City of Turlock*, 170 Cal. App. 3d 988 (1985) (Insurance Code § 533 does not bar coverage for vicarious liability based on the willful tort of an employee.); *Dart Industries, Inc. v. Liberty Mut. Ins. Co.*, 484 F.2d 1295 (9th Cir. (Cal.) 1973) (Intentionally injurious acts of insurance corporation president do not bar coverage for the corporation under Insurance Code § 533 because neither the board of directors nor the shareholders are authorized to ratify such behavior.).

⁹*Lumberman's Mut. Cas. Co. v. Hanover Ins. Co.*, 38 Mass. App. Ct. 53 (1995) (Lessor, sued by an employee of lessee where both lessor and lessee were covered under the policy, was entitled to coverage.); *Wilson v. State Farm Mut. Auto. Ins. Co.*, 540 So. 2d 749 (Ala. 1989) (Company and supervisory employees, all insured under the policy, were sued by employee of company; “employee injury” barred coverage for company but not for supervisor and three employees.).

3. There Was No “Offense” During the Policy Period; Therefore, No Potential for Coverage Exists

“Personal injury” and “advertising injury” coverage under commercial liability policies is tied to the commission of an offense “in the coverage territory during the policy period.” The triggering event is the act that causes the injury, not the injury itself.¹⁰

4. The Underlying Claimant Asserts a Claim for Damages Based on Breach of Contract and There Is an Express Exclusion for Same

Where a tort claim is asserted, even in conjunction with the contract action, the typical breach of contract exclusion should not bar a defense.¹¹ The underlying claim arises out of a known loss or a loss-in-progress, and thus no duty to defend can exist. The majority view is that the known loss or loss-in-progress doctrine requires a loss, not a claim. Otherwise, it would be denoted as a claim or knowledge of potential liability exclusion. This limited public policy doctrine, while given expansive construction in Texas, is elsewhere properly limited to an adjudication against an insurer which precedes policy inception.¹²

¹⁰*Atlantic Mut. Ins. Co. v. J. Lamb, Inc.*, 100 Cal. App. 4th 1017, 1032 (2002):

2. Principles of Personal Injury Coverage

Like advertising injury, “personal injury” is a term of art that describes coverage for certain enumerated offenses that are spelled out in the policy. . . . Coverage for personal injury [advertising injury] is not determined by the nature of the damages sought in the action against the insured, but by *the nature of the claims* made against the insured in that action. Under the personal injury [advertising injury] policy provision, “[c]overage . . . is triggered by the offense, not the injury or damage which a plaintiff suffers.”

¹¹*Zurich Ins. Co. (U.S. Branch) v. Killer Music, Inc.*, 998 F.2d 674 (9th Cir. 1993) (A copyright infringement claim falls within the scope of “advertising injury” and, because the claim could sound either in tort or contract, a carrier’s ex-contractual arguments are inapplicable.). See *Vandenberg v. Superior Court*, 21 Cal. 4th 815, 841, (1999):

“The coverage agreement [which] embraces ‘all sums which the insured shall become legally obligated to pay as damages’ . . . is intentionally broad enough to include the insured’s obligation to pay damages for breach of contract as well as for tort, within limitations imposed by other terms of the coverage agreement (e.g. bodily injury and property damage as defined, caused by an occurrence) and by the exclusions” (Tinker, *Comprehensive General Liability Insurance--Perspective and Overview* (1975) 25 Fed. Ins. Coun. Q. 217, 265.)

¹²*Stonehenge Eng’g Corp. v. Employers Ins. of Wausau*, 201 F.3d 296, 301-02 (4th Cir. (S.C.) 2000) (Knowledge of a claim or a lawsuit pending is insufficient to constitute a “known loss” without proof that the insured had pre-policy inception “actual knowledge” or was “substantially certain the loss would occur.”); *Montrose*

5. No Timely Notice Was Provided of the Claim; Therefore, There Is No Duty to Defend

Under the majority of jurisdictions, notice is a condition to the policy, but to effectuate its terms, prejudice must be demonstrated. Exceptions include jurisdictions such as New York and Illinois. The majority rule is followed in California and most other significant jurisdictions.¹³ Some jurisdictions, such as Florida, Connecticut, Ohio and Indiana, agree with the prejudice rule but put the burden on the insured, not the insurer, to show the absence of prejudice.

6. Your Failure to Cooperate with the Insurer Bars You from Coverage

The “cooperation” provision is typically asserted by insurers when a policyholder defended under a representation of rights seeks to settle a lawsuit absent notice to the insurer. While most jurisdictions will permit settlement after an insurer denies notice, without further insurer involvement, it is good practice to let the insurer know that a proposed settlement will be consummated soon and to give the insurer a chance to reevaluate its coverage position and participate.

Nevertheless, the better and emerging majority rule is that a defending insurer, who is defending through independent counsel due to conflicts of interest between the insured and the insurer, need not consent to a settlement so long as it is reasonable and noncollusive.”¹⁴ Some

Chem. Corp. v. Admiral Ins. Co., 10 Cal. 4th 645, 693 (1995) (“Stated differently, the loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer entered into the contract of insurance with the policyholder, that the insured had a legal obligation to pay damages to a third party in connection with a loss.”).

¹³*Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865 (1978) (An insurer must prove that it was “substantially prejudiced” by a purported breach of the notice of cooperation conditions contained in the insurance policy.); *Cooper v. Government Employees Ins. Co.*, 51 N.J. 86 (1968) (Insurer has a burden to show that it was “appreciably prejudiced” by the insured’s purportedly late notice to seek coverage based on late notice.).

¹⁴*United Servs. Auto. Ass’n v. Morris*, 154 Ariz. 113 (1987) (An insured being defended under a reservation of rights may enter a settlement agreement with an underlying claimant without breach of the “cooperation clause.” In order for the insurer to be liable for such settlement, the insured need only show that settlement was “reasonable and prudent.”); *Ha 2003, Inc. v. Federal Ins. Co. (In re HA 2003, Inc.)*, 310 B.R. 710, 723-24 (Bankr. N.D. Ill. 2004) (“[B]y providing the insured with independent counsel while reserving a right to contest coverage, an insurer

jurisdictions even permit an assignment of the policy rights to a claimant who could then enforce the settlement against an insurer.¹⁵

7. As an Umbrella or Excess Umbrella Carrier, We Have No Obligation to Defend and We Have Exhausted the Underlying Insurance

Courts are divided as to whether exhaustion arises where an underlying carrier is bankrupt. In other fact scenarios, there is often explicit drop-down language in umbrella policies that applies where the breadth of coverage in the umbrella policy is broader than that of the primary policy or the primary policy denies a defense. In such a circumstance, the umbrella carrier can be separately sued and then it may have contribution rights against the primary.¹⁶ There is, nonetheless, some authority for the contrary rule, requiring all primary policies to be exhausted before the umbrella policy limits are accessed, though its efficacy at present is uncertain.¹⁷

8. Although We Have Never Raised This Issue Before, Your Claim Is Not Covered Because of XYZ Reason

renounces control of the litigation and thrusts responsibility for the litigation on the insured, who is then free to enter into a reasonable settlement.”).

¹⁵*Miller v. Shugart*, 316 N.W.2d 729, 733-34 (Minn. 1982) (Although there had not been an actual trial and even though the insurer had not joined in the settlement, the court held that the plaintiff could enforce the stipulated judgment against the insurer so long as the plaintiff could establish that the underlying settlement was not obtained by fraud or collusion and that the settlement was reasonable and prudent.).

¹⁶*SCSC Corp. v. Allied Mut. Ins. Co.*, 515 N.W.2d 588, 599 (Minn. Ct. App. 1994) (The insured has the right to “pick and choose” any one of the successfully “triggered” policy periods and “vertically” exhaust all of the policies in that policy period to pay the entire liability for the insured. Thus, no horizontal exhaustion of all “triggered” primary-level policies must be achieved before policy benefits are sought under a particular umbrella policy.).

¹⁷*Iolab Corp. v. Seaboard Sur. Co.*, 15 F.3d 1500, 1504-05 (9th Cir. 1994):

First, under California law, it is clear that “[a]ll primary insurance must be exhausted before liability attaches under a secondary policy.” *Olympic Ins. Co. v. Employers Surplus Lines Ins. Co.*, 126 Cal. App. 3d 593, 599, 178 Cal. Rptr. 908 (1981). . . .

. . . The policy behind the *Hartford* holding, to avoid the imposition of unnecessary litigation costs on excess insurers, applies to a breach of contract claim and to an action for declaratory relief alike. . . . Regardless of how Iolab’s claim against the excess insurers is labeled, requiring the excess insurers to defend against Iolab’s claim would impose on the excess insurers the unnecessary cost of litigating a claim that may never trigger excess coverage and thereby would frustrate the policy adopted by California courts.

Under the applicable law in most jurisdictions, policyholders are entitled to a defense immediately. If the fact allegations in the underlying claim (fact assertions in complaint, as well as other facts made known to the insurer), no “investigation” is required to establish the insurer’s obligation to defend.¹⁸ Estoppel may apply where a policyholder demonstrates it suffered detriment as a result of an insurer’s act or omission.¹⁹

9. You Have No Present Coverage for Conduct That Arose under a Prior Policy of an Acquired Company

A company acquiring another company may have liability under the terms of its acquisition for the prior company’s conduct of which the acquiring company was unaware. Limitations in general liability policies that preclude access to an acquired company’s policy benefits should be viewed with suspicion. Rules may differ, however, where there is an asset purchase, as opposed to an acquisition or merger.²⁰

Where the acquired company is a co-defendant with the policyholder, the acquired company’s coverage may be broader than that of the acquiring company. This often occurs when smaller companies with broader coverage and no substantially self-insured retention or deductibles have coverage in place due to an occurrence within their policy period. Indeed, an umbrella policy broadly defining “insureds” to include joint ventures may extend coverage to even informal company interactions that do not include an acquisition. While procuring a defense for the benefit of the entity with which it had a joint venture relationship, it did not vitiate its possible concern about the need for distinct counsel. Where it was willing to waive

¹⁸*Jarchow v. Transamerica Title Ins. Co.*, 48 Cal. App. 3d 917, 942-43 and 943-44 (1975) (“Investigator” response is improper because it improperly equates duty to defend with duty to indemnify.).

¹⁹*See, e.g., Miller v. Elite Ins. Co.*, 100 Cal. App. 3d 739, 754 (1980) (“Where an insurer reserves its right to claim noncoverage under the policy, notice of the reservation must be given to the insured or the reservation is deemed waived.”); *Maneikis v. St. Paul Ins. Co.*, 655 F.2d 818, 821 (7th Cir. 1981) (“Once an insurer violates its duty to defend, it is estopped to deny policy coverage in a subsequent lawsuit by the insured or the insured's assignee.”).

any conflicts and accept counsel defending the joint venture defendant, it could in effect take the full policy benefits through that other policy for which it did not pay any premium expense.

10. Under the Law of State X, Your Recovery Is Limited

Insurers will often apply the law of the state where an underlying action is pending and purport to, therefore, have done the appropriate coverage analysis, or they will choose the most favorable law and rely on its law in their coverage opinion.

Ultimately and critically for policyholders, the question of what law applies depends on where a suit is initiated. The choice-of-law rules of that jurisdiction will then govern. A selection of a forum selects the choice of law and it, in turn, will determine what substantive law applies. Thus, policyholders who initiate litigation in their chosen forum may be able to control the law to be applied by the court. Therefore, where there are significant variations in applicable law, it is critical that policyholders think of initiating suit to best position themselves to secure the most favorable law available.

IV. COVERAGE PROVISIONS THAT WHITTLE DOWN POLICY BENEFITS WITHOUT FULLY ELIMINATING THEM

A. The “Voluntary Payments” Provision Bars Coverage for Pre-Tender Defense and Indemnity Costs

Most jurisdictions have agreed that “voluntary payments” provisions are enforceable and preclude recovery of fees prior to notice. Notice, of course, can be constructive and, where notice goes to an agent of an insured, that notice may be deemed notice to an insurer.²¹

This troublesome provision has been especially problematic for policyholders seeking a defense in intellectual property and antitrust litigation for the following reasons:

²⁰*See Henkel Corp. v. Hartford Acc. & Indem. Co.*, 29 Cal. 4th 934 (2003).

²¹*Estate of Parker v. AIG Life Ins.*, 317 F. Supp. 2d 1167, 1171 (C.D. Cal. 2004).

First, such claims are not as readily tendered to the appropriate carriers because the first carrier on risk is not always evident from the face of the pleadings.

Second, the general counsel may not realize that there are policy benefits for such claims available nor may risk management appreciate how the coverage it secured may address a number of such claims.

Third, such litigation typically involves legal theories that are untested and require significant analysis to assess if there is exposure.

Fourth, many policyholders wish to test a litigation's merits before they give notice or, if significant self-insured retentions are at issue, delay any notice until clear policy benefits are available.

Fifth, policyholders are often unaware of coverage that may readily benefit them on a first dollar basis. Free-standing international coverage can often be implicated on a first-dollar basis,²² even by major corporations' where the conduct creating liability alleged falls outside, as well as inside, the United States, even though the lawsuit is in the United States.

B. We Will Pay Only a Portion of Defense Indemnity Costs Because Other Insurers Are on Risk

The simple fact is that coverage law typically renders the primary carrier's obligation indivisible. It must pay all defense fees accrued. Its other insurance provisions may give it contribution rights against other carriers, but these cannot vitiate its own primary duty. Both the "all sums" language of typical liability policies and pertinent law allow the insured to pick its preferred insurer and then obtain the full benefits therefrom. Indemnity is different in that there may be distinct periods when damages accrued are better implicated by a particular offense

²²See *Hewlett-Packard Co. v. CIGNA Property & Cas. Ins. Co.*, No. 99-20207 SW, 1999 U.S. Dist. LEXIS 20655 (N.D. Cal. Aug. 24, 1999).

because the conduct creating liability for the offense only occurred during certain periods of time. Where damages accrue in a way that is not linkable to only one particular policy, however, other methods of allocation beyond looking to the event triggering liability must arise. Little case law has yet to address this issue for offense-based policies.

C. Where Contribution Is Sought Against Other Carriers Subject to Self-Insurance Mechanisms, Insureds Should Not Suffer

Where multiple insurers are on risk due to a continuing tort, and damages are sought for conduct in multiple policy periods, insurers will seek to attribute indemnification exposure to policies other than their own and seek to urge that, in seeking contribution for the defense costs, carriers with significant self-insured retentions must supplement their contribution by that by the insured itself. Courts have not been sympathetic to these requests.²³

D. Thus, Both Defense and Indemnification Should Be Allocated Costs in a “Mixed Action”

As to defense fees, this issue was put to rest in California by *Buss v. Superior Court*, which found that the entire defense is due by an insurer in a “mixed action.”²⁴ The defense of the noncovered claims, however, is prophylactic and an insurer can seek reimbursement if it performs in accordance with its obligations fully and completely. Similarly, if it pays a settlement which turns out to have not been for potentially covered claims, it may seek reimbursement. Some jurisdictions agree; others do not. The majority rule is that allocation of defense fees is only proper in the rarest instances where the insurer can establish that particular

²³*New Castle County v. Continental Cas. Co.*, 725 F. Supp. 800, 817 (D. Del. 1989) (“Because only rights among carriers are implicated by the ‘other insurance’ clause, contribution and allocation among insurers may not impose any liability on the [insured.]”); *Detrex Chem. Indus., Inc. v. Employers Ins. of Wausau*, 746 F. Supp. 1310, 1326 (N.D. Ohio 1990) (“[T]his court is in agreement that the ‘other insurance’ clauses in the Wausau insurance policies cannot be used to impose additional liability [for defense or indemnity], [on the insured] by way of deductibles or otherwise, should any of such policies be found to be triggered.”).

²⁴*Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997).

defense fees can be allocated to uncovered claims. This is very difficult to do, especially in intellectual property and antitrust lawsuits.

Allocation is not tenable where a settlement agreement arises prior to the adjudication of liability. In requiring most insurers to pay the full amount of any reasonable settlement so long as any potentially covered claim exists at the time of the settlement, courts follow principles of common sense. There has been no adjudication of liability; therefore, actual coverage is not a real possibility. To the extent courts use actual coverage language in implementing such policy provisions, they typically require proof of claims that would be covered had liability attached in the way that the pleading suggests.²⁵

Under the “greater settlement rule,” the reimbursement obligations of a D&O policy typically preclude allocation. Where covered individual directors and officers are sued by the noncovered company, so long as the benefit achieved inures to the individual officers, the incidental benefit to the company is of no moment.²⁶ Most courts have also found that an obligation to advance defense costs applies.²⁷

E. Coverage for the Underlying Claim Is Subject to Multiple Per Claim or Per Occurrence Deductibles, SIRs or Retro Premium Payments

²⁵*United States Fire Ins. Co. v. Green Bay Packaging, Inc.*, 66 F. Supp. 2d 987, 999 (E.D. Wis. 1999) (“A duty to indemnify exists if acts occur that are insured against. Where a claim consists of a variety of acts, some of which are covered and others that are not, it is well settled that resulting liability falls within the terms of the insurance policy unless the uncovered risk is the sole cause of damages.”); *Guillen v. Potomac Ins. Co.*, 785 N.E. 2d 1, 11-12 (Ill. 2003) (“Potomac does not dispute that, generally speaking, once an insurer breaches its duty to defend, the insured may enter into a reasonable settlement agreement without foregoing its right to seek indemnification. *See Outboard Marine*, 154 Ill. 2d at 128.”).

²⁶*Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424 (9th Cir. 1995) (Indemnification policy does not provide for a defense, but permits implication of a right to receive full sum paid in settlement as long as monies paid benefited covered officers and directors, and only incidentally benefited uncovered corporation.).

²⁷*Gon v. First State Ins. Co.*, 871 F.2d 863 (9th Cir. 1989); *Okada v. MGIC Indem. Corp.*, 823 F.2d 276 (9th Cir. 1986) (D&O carrier liable for contemporaneous reimbursement of defense costs of their policy that contained no duty to defend, but only a duty of indemnity costs.).

Self-insurance mechanisms create issues where policyholders face unrelated multiple claims. An offense may arise out of a specific publication of allegedly disparaging material in Year 1 where Carrier A is subject to exposure and be subject to a SIR. A subsequent carrier with multimedia coverage, Carrier B, has no SIR and may also be liable for distinct claims of trademark infringement which first incept in Year 2. A defense is due for the entire lawsuit by Carrier B with no SIR. It can seek contribution against Carrier A, but the insured need not contribute or have its defense fees impacted in such a fact scenario.²⁸

V. CONCLUSION

Insurers that write coverage under Commercial Liability Insurance policies for “offense” based “advertising injury” and “personal injury” coverage often adopted the policy forms without performing any underwriting. When claims appear that are costly, requiring expert knowledge of business torts (including exposure for intellectual property and antitrust lawsuits), they may not have sufficient in-house expertise to assess whether the policy’s language will be potentially implicated by such claims. Even those insurers who have created specialty claims departments will often defer to the expertise of outside coverage counsel. They in turn may adopt overly narrow constructions of coverage precipitating denials. These policy constructions, however may not be in accord with rulings reached by the majority of courts.

If the goal is to choose colorable interpretations that are not subject to in “bad faith,” these coverage opinions may suffice. Yet, as courts clarify the law in a number of forums, such conduct may itself constitute a breach of the covenant of good faith and fair dealing. For

²⁸ *Atlantic Mut. Ins. Co. v. J. Lamb, Inc.*, 100 Cal. App. 4th 1017, 1032-33 (2002) (“The triggering event is the insured’s *wrongful act*, not the resulting injury to the third party claimant. Indeed, coverage will exist for a personal injury ‘offense,’ *committed during the term of the policy*, even if the injury occurs *after* the policy expires. (American Cyanamid Co. v. American Home Assurance Co. (1994) 30 Cal.App.4th 969, 982, [35 Cal. Rptr. 2d 920].”).

example, the insurer's view that "infringement of title" in its "advertising injury" coverage for the offense of "infringement of copyright, title or slogan" means only a literary or artistic title has been rejected by the majority of courts where no intellectual property exclusion was at issue.²⁹ This is undoubtedly why some insurers here changed their policy language to expressly limit their covered offense to "infringement of literary or artistic titles." Better to narrow the policy language then risk a costly loss in court. This insurer response has led to narrower and narrower CGL policy coverage provisions.

Policyholders need to carefully review all the forms of Commercial Liability Coverage they purchase and procure the broadest forms now available to facilitate their ability to argue for coverage in business tort lawsuits. At present, the broadest policy forms available on the two coasts appear to be a 1998 ISO (CGL) Primary and a 1986 ISO (CGL) Umbrella. Policyholders in other parts of the country may more readily procure a 1986 ISO (CGL) Primary and a 1998 ISO (CGL) Umbrella policy.³⁰ Insurance brokers who are unwilling to search for and locate the broadest coverage available to their policyholders in the marketplace should be replaced with those who are willing to perform that service. As the insurance market continues to soften, the best policy coverage will flow to the most vigilant policyholders aided by astute and proactive insurance brokers.

²⁹ *Finger Furniture Co., Inc. v. Travelers Indem. Co.*, Civil Action No. H-01-2797, 2002 WL 32113755, *10 (S.D. Tex. (Houston Div.) Aug. 19, 2002) ("... 'TRUE VALUE' could certainly be considered a 'title or slogan,' and an infringement of that mark potentially fits within the Policy, under the fourth definition of 'advertising injury.'"); *Palmer v. Truck Ins. Exch.*, 21 Cal. 4th 1109, 1118 (1999) ("[For] 'infringement of copyright, of title or of slogan' ... other courts interpreting insurance policies have broadly defined 'title' to encompass any name ...").

³⁰Typically, these policy forms are not available through Hartford, Chubb, AIG or St. Paul/Travelers. For a list of insurers that may still sell the broader forms, contact me at dag@gauntlettlaw.com.