Insurer's Duty to Defend: Resolving Defense Cost Issues
Strategies for Cost Reimbursement and Allocation

A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today’s panel features:
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Insurer’s Duty To Defend: Resolving Cost Issues

Duty & Right To Defend, Targeted Tender, Pre-Tender Costs, & Other Defense Cost Issues

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Insurer’s Duty To Defend: Resolving Cost Issues

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- Please see the accompanying materials.
Scope Of The Duty To Defend

- The duty to defend is contractual. The policyholder does not have a constitutional right to a defense.
- If the policy does not impose a duty to defend, there should be none and most cases so hold.
- As a general matter: most primary general liability policies impose a defense obligation; excess policies do not require an insurer to defend; and umbrella policies often impose a defense obligation only where the lawsuit is “not covered” by the primary policy, but is covered under the umbrella policy.
- Under the laws of many states, the duty to defend is considered broader than the duty to indemnity -- lawsuits involving claims “potentially” covered.
- Under the laws of many states, where an insurer has a duty to defend, it must defend the entire lawsuit even where only one or some of the claims are potentially covered.
- There are exceptions to all of the above and you have to look at the law, the policy language, and the facts.
Consequences For Breaching The Duty to Defend

- The consequences for breaching the duty to defend vary greatly from state to state and depending upon the facts.
- Potential consequences include: breach of contract damages for attorneys fees and costs incurred in defending action; liability for judgment up to policy limits; liability for excess judgment (bad faith); loss of control of the defense; ability to challenge settlement may be limited (collusion, fraud, unreasonable, etc.); forfeiture of coverage defenses or estoppel.
- The scope of the duty to defend, the consequences of breaching the duty to defend, and litigation realities make it such that an insurers often pay or are asked to pay costs that are not covered.
The Right To Defend

- Generally, the duty to defend is performed by the insurer selecting counsel and paying counsel to defend.
- An insurer that has a duty to defend, usually also has the right to defend – which means the right to select counsel and control the defense. If a policyholder retains its own counsel, it must pay.
- Where the interests of the insurer and the policyholder conflict in connection with the defense of a suit, in some states (tripartite) the duty to defend may be transformed into an obligation to pay defense costs.
- *Cumis/Peppers* counsel.
- The dynamics change because the party that is being asked to pay the defense costs (the insurer) is not selecting the counsel or controlling the defense, and often is kept in the dark about the case.
Underpinnings For Reimbursement/Recoupment

- Primary insurer with a defense obligation (potentially covered standard) or an excess insurer reimbursing defense costs (actually covered standard) may be paying defense costs associated with uncovered claims.
- This part was mostly by way of setting the stage for Linda’s discussion of reimbursement.
- Can the insurer recover defense costs associated with claims not even potentially covered in a mixed claims context.
- What must the insurer do?
  Nothing
  Reserve rights
  Show the claim is not covered or potentially covered
  Identify the costs that relate solely to non-covered claims
Other “Defense Cost” Issues

- There often are important issues relating to “defense costs” apart from seeking or obtaining reimbursement for defense costs associated with non-covered claims. These include: whether some costs are for prosecuting claims or recoveries; excessive, duplicative, unnecessary, and unreasonable costs; costs not directly related to defense of claims; billing rates and counsel selection, etc.
- Cost characterization issues such as whether RI/FS costs are defense costs or indemnity costs.
- Guidelines, bill reviews, audits, and other tools insurers use.
Targeted Or Selective Tender

- There is a line of cases that, under certain circumstances, allows a policyholder to tender its defense to one of its primary insurers, but not another, and thereby nullify the “targeted” insurer’s rights of equitable contribution (as to both defense and indemnity) against the non-selected insurer.

- Policyholders would like to expand the doctrine to long-tail claims so that they can obtain to leverage that they hoped to achieve through obtaining a “joint and several” or “all sums” allocation.

- Even if a policyholder obtains an “all sums” ruling, generally insurers can reallocated any disproportionate share they get saddled with through contribution claims and the net difference between an “all sums” and pro rata allocation may be de minimus, depending upon such factors as the amount of insolvent insurers within the policyholders’ insurance program.

- If a policyholder can make its selection stick, it provides it with leverage and it can entice other insurers to defend it or settle with it.
Application Of Targeted Tender

- Where the doctrine applies, it does render “other insurance” clauses useless and does saddle the “targeted” insurer with defense and indemnity.
- The policyholder does retain some flexibility because it can “de-select” and keep other coverage available to it on a “stand by” basis.
Properly Viewed, Targeted Tender Is A Limited Doctrine

- Origin & application: construction context involving a property owner and contractor or a general contractor and subcontractor. Often the construction contract/indemnity agreements between the parties are intended to shift the loss.

  - Doctrine limited to concurrent, primary contracts
  - Doctrine does not override the doctrine of horizontal exhaustion

- Long tail claim disputes typically involve consecutive, not concurrent contracts.

- Most of the decisions involving the targeted tender rule are Illinois cases.
Targeted Tender Doctrine Is Largely Confined To Illinois

- But some courts in other jurisdictions have addressed targeted tender. *Mutual of Enumclaw Insurance Co. v. USF Insurance Co.*, 191 P.3d 866 (Wash. 2008) (Acknowledged the targeted tender rule and excused a non-selected carrier from liability for contribution or coverage).


- *Cargill, Inc. v. ACE American Insurance Co.*, 766 N.W.2d 58 (Minn. App. 2009), *appeal granted*, No. A08-1082 (Minn. Aug. 11, 2009). The policyholder targeted coverage for its defense from one primary insurer and refused to enter into loan receipt agreements allowing the targeted insurer to seek contribution from other non-targeted insurers. The court held that equity requires a court to impose a constructive loan receipt agreement that allows a primary insurer to obtain equitable apportionment of defense costs among all primary insurers with a duty to defend.
Some courts in other states effectively reach the same result in the construction claim context without invoking any targeted tender rule by holding that co-insurers’ “other insurance” clauses have no impact on their respective rights and obligations when the underlying parties’ hold harmless and indemnity agreements address how the risk of loss is to be borne. *See, e.g.*, *Ross v. Prevost*, 200 Cal. App. 2d 570 (1st Dist. 1962) (holding that the indemnification agreement in a construction contract between a property owner and a contractor controlled the coordination of coverage between the property owner’s insurer and the contractor's insurer, whose insurance contract included the property owner as additional insured, reasoning that “to apportion the loss in this case pursuant to the other insurance clauses would effectively negate the indemnity agreement and impose liability on [the property owner’s insurer] when [the property owner] bargained with [the contractor] to avoid that very result as part of the consideration for the construction agreement”); *American Indem. Lloyds v. Travelers Property & Cas. Ins. Co.*, 335 F.3d 429 (5th Cir. 2003) (applying Texas law) (“an indemnity agreement between the insureds or a contract with an indemnification clause, such as is commonly found in the construction industry, may shift an entire loss to a particular insurer notwithstanding the existence of an 'other insurance' clause in its policy.”)
Pre-Tender Defense Costs


- An insurers’ duty to defend does not arise until the insured provides notice and requests a defense.

- The voluntary payments provision contained in many CGL policies (e.g., 2001 ISO CGL policy form) provides that no insured will, except at that insured’s own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without the insurer’s consent.

- The duty to defense is also a right to defend and affords the insurer the right to control the defense.
Pre-Tender Defense Costs

- Some courts have found pre-tender defense costs covered. See, e.g., American Red Cross v. St. Paul Travelers, 293 Fed. Appx. 512 (9th Cir. 2008) (Cal. law) (finding exception to bar of recovery for pre-tender costs where an insured was unaware of the existence or contents of the policy and, therefore, was unable to tender); Fiorito v. Superior Ct., 226 Ca. App. 3d 433 (4th Dist. 1990) (insured could recover pre-tender costs if it could demonstrate that costs were involuntarily incurred and no opportunity to obtain approval of insurer existed).

- Those jurisdictions that allow recovery of pre-tender defense costs address responsibility for pre-tender defense costs in connection with the policy’s notice provisions. See, e.g., TPLC, Inc. v. United Nat. Ins. Co., 44 F.3d 1484 (10th Cir. 1995) (applying Pa. law) (insurer cannot avoid paying pre-tender costs absent a showing of prejudice); Cincinnati Companies v. West American Ins. Co., 701 N.E.2d 499 (Ill. 1998); PAJ Inc. v. Hanover Ins. Co., 243 S.W.3d 630 (Tex. 2008) (an insured’s failure to timely provide notice to an insurer of a claim will not bar coverage absent a finding that the delay prejudiced the insurer).
Settlement Issues

- Reservation of rights
- Settlement agreements
- Coverage-in-place agreements
- Interim funding agreements
- Formal or informal cost sharing arrangements
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Allocation of Costs

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Sherilyn Pastor is the Practice Leader of McCarter & English’s Insurance Coverage Group, and a member of the Firm’s Executive Committee. She has secured hundreds of millions of dollars in insurance assets for a broad range of policyholder clients. She also provides advice to clients assessing their potential risks, analyzing new insurance products and considering the adequacy of their existing insurance programs.

Ms. Pastor is the Vice-Chair (Policyholder Side) of the ABA’s Insurance Coverage Committee. She publishes and lectures frequently on a variety of topics including insurance coverage, trial advocacy, pretrial practice and professional responsibility. She serves on the Editorial Boards of the Insurance Coverage Law Bulletin, and Appleman on Insurance. She teaches the National Institute for Trial Advocacy’s trial and deposition skills programs. She is a member of the New Jersey Supreme Court’s Professional Responsibility Rules Committee.

Ms. Pastor was named one of New Jersey’s “2010 Best 50 Women in Business” by NJBIZ, a weekly business journal recognizing women for their outstanding contributions to their industry and community. She is recognized in The International Who’s Who of Insurance & Reinsurance (2010), and as a New Jersey Super Lawyer (2006-2010).
When Is Allocation Needed?

- Complaint alleges covered and uncovered claims ("Mixed" Action)
- Multiple parties potentially responsible for covered claims
  - Multiple policies covering same liability concurrently
  - Primary and excess insurance
  - Liability extends over multiple policy periods
- Insurer and Insured responsible for covered claims
  - Liability may extend to uninsured time periods depending on allocation method employed
“Mixed” Action

- Suits may include both covered and non-covered claims
  - E.g., tort action alleges both intentional (non-covered) and negligent (covered) injuries
  - E.g., injury may have been caused either by acts during policy period (covered) or by acts outside the policy period (non-covered)
“Mixed” Action

- For “mixed” action, general rule requires insurer to defend entire action until no potentially covered claims remain

- In some jurisdictions, insurer may later permitted to seek reimbursement of costs related to defense of claims not even potentially covered by the policy
“Mixed” Action

- In some jurisdictions, if “mixed” action causes conflict of interest between insurer and insured, duty to defend becomes duty to reimburse insured for defense of covered claims only
“Mixed” Action - Possible Conflicts

- Vigorous defense on covered claims but not uncovered claims to end defense obligation and avoid indemnity obligation

- Steer defense to make the likelihood of plaintiff success higher on uninsured (vs. insured) theories

- Gain access to confidential and privileged information which insurer may use to its advantage in a coverage action
Allocation in “Mixed” Action

- Insurance contract obligates insurer only to pay for those claims covered by the policy
  - “The duty to defend arises solely under contract. An insurer contracts to pay the entire cost of defending a claim which has arisen within the policy period. The insurer has not contracted to pay defense costs for occurrences which took place outside the policy period. Where the distinction can be readily made, the insured must pay its fair share for the defense of the non-covered risk.”

Allocation in “Mixed” Action

- In allocating defense costs between covered and uncovered claims, insured and insurer should attempt to reach agreement
  - “We presume that the insurer and insured can negotiate a satisfactory settlement that fairly apportions the defense costs.”

Allocation in “Mixed” Action

- If parties cannot agree, court should determine fair division of cost by analyzing complaint in light of coverage under policy
  - “When [the insurer and insured] are unable to agree [on apportionment of defense costs between covered and uncovered claims], we likewise presume that our courts will be able to analyze the allegations in the complaint in light of the coverage of the policy to arrive at a fair division of costs.”
  

- The burden of proving an expense was for an uncovered claims is on the insurer
Allocation in “Mixed” Action

- If neither parties nor court can apportion defense costs between covered and uncovered claims, insurer is responsible for entire defense costs
  
  - “Following . . . the general rule, an insurer is clearly liable for all expenses if they cannot be apportioned.”

Allocation in “Mixed” Action

- Some states assume most defense costs can be apportioned
  - *SL Indus., Inc. v. Am. Motorists Ins. Co.*, 607 A.2d 1266, 1279 (N.J. 1992) (“However, the lack of scientific certainty does not justify imposing all of the costs on the insurer by default. The legal system frequently resolves issues involving considerable uncertainty.”)

- Other states presume apportioning defense costs is difficult or impossible
Allocation Among Parties

- Concurrent Policies
  - Multiple policies provide overlapping coverage for same risk

- Consecutive Policies
  - Multiple policies provide successive coverage in same policy period (primary and excess insurance)
  - Multiple policies provide successive coverage over multiple policy periods
Concurrent Policies

- Analyze “other insurance” clauses to determine if policies are concurrent or consecutive
  - If clause renders one carrier primary and other excess, policies are consecutive – *Samuels v. State Farm Mut. Auto. Ins. Co.*, 939 So. 2d 1235 (La. 2006)
Concurrent Policies

- Examples of Concurrent Policies:
  - Primary policy covers some of the claims but umbrella policy covers others - *Jostens, Inc. v. Mission Ins. Co.*, 387 N.W.2d 161 (Minn. 1986)
Concurrent Policies

- General Rule permits allocation of defense costs among concurrent policies

- Minority of courts do not permit allocation of defense costs among concurrent policies
  - Obligation of the insurers that insure identical risk is to the insured, not each other
Concurrent Policies

- In at least one jurisdiction, when primary and umbrella insurer each liable for part of defense, burden of allocating defense costs rests on primary insurer
Allocating Among Concurrent Policies

- **Majority – Pro Rata by Policy Limits**
  - Each insurer contributes ratio of individual insurer’s limits as portion of entire applicable limits

- **Minority – Pro Rata by Equal Shares**
  - Total cost divided by number of insurers
Consecutive Policies

- Examples of Consecutive Policies:
  - Primary and excess policies in single policy period
  - Multiple primary and excess policies covering multiple policy periods impacted by single long-tail loss
Consecutive Policies

- Excess policy duty to defend arises from contractual language of policy
  - Duty to defend upon exhaustion of primary; or
  - Duty to pay “ultimate net loss”, including defense costs, but not provide defense to insured

- Policy language generally determines whether excess must provide a defense or reimburse insured for defense costs
Consecutive Policies

- Minority of jurisdictions imply excess has duty to defend if not explicitly excluded by policy
Consecutive Policies

“The majority rule is that where the insured maintains both primary and excess policies, the excess liability insurer is not obligated to participate in the defense until the primary policy limits are exhausted.”

Consecutive Policies

- When case involves multiple claims, primary is responsible for defense costs until it has paid out its policy limits in settlement.
- Excess is responsible for subsequently incurred defense costs for remaining claims.

Consecutive Policies

- When case concludes with settlement in excess of primary limits, how are defense costs allocated between primary and excess insurers?
  - Primary pays all defense (no defense costs incurred after excess triggered by settlement)
    - *Schneider Nat’l Transp. v. Ford Motor Co.*, 280 F.3d 532, 538 (5th Cir. 2002)
  - Primary and excess pay pro rata share based on percentage of settlement paid by each
Consecutive Policies

- Various methods exist for allocating defense costs for long-tail claims that impact multiple policies and policy periods
  - All Sums/Pick and Choose
  - Pro Rata by time on the risk
  - Pro Rata by time on the risk weighted by limits
Consecutive Policies

- All Sums/Pick and Choose
  - Allows insured to pick which of the triggered insurers will provide a defense
  - Picked insurer has right to seek reimbursement later from other insurers
  - Insured not allocated any of the costs
Consecutive Policies

- **Pro Rata by time on the risk**
  - Defense costs allocated to insurers based on the amount of time covered by each insurer’s policies in relation to the total time of the risk
  - Allocates defense costs to insured for periods of self-insurance (i.e., no insurance purchased)
  - Defense costs not allocated to insured for periods for which insurance was unavailable
Consecutive Policies

- Pro Rata by time on the risk weighted by limits
  - Defense cost allocation formula is “proration on the basis of policy limits, multiplied by years of coverage.”
  - Insured responsible for defense costs allocated to uninsured periods or policies excluding coverage
  - Defense costs are not allocated to periods for which coverage was unavailable
Allocation to Uninsured Time Periods

- In a scenario involving long-tail claims over multiple policy periods that include uninsured time periods:
  - If insurance was available but the insured did not procure insurance and retained the risk, the insured is responsible for defense costs allocable to uninsured periods.
  - If insurance for the loss was not available, those uninsured time periods are not included in the allocation and all losses are allocated to insured, not uninsured, time periods.

Insurer's Duty to Defend: Resolving Cost Issues

Strategies for Defense Cost Reimbursement and Allocation

Linda D. Kornfeld
August 17, 2010
"Reimbursement" - Framing the Issue

1. Insurer agrees to defend pursuant to reservation of rights, including “right of reimbursement”

2. What does that mean - defense fee payments simply are an “advance”?

3. Problems for policyholders created by insurer claimed “right of reimbursement”

4. Policyholders should not presume that insurer’s claimed “right” is legally enforceable
Claimed "Majority" View

*Buss v. Superior Court* (California)

• Reimbursement is proper if no potential for coverage ever existed

• Insured would receive a “windfall” if reimbursement not allowed
Other Claimed "Majority" View states

1. Alaska
2. Colorado
3. Delaware
4. Florida
5. Tennessee
The “New Majority” View

**General Agents Insurance v. Midwest Sporting Goods** (Illinois)

- “The fact that the trial court ultimately found that the underlying claims against Midwest were not covered by the (General Agents) policies does not entitle (General Agents) to reimbursement of its defense costs”

**Nationwide Mutual Insurance v. Mortensen** (Connecticut)

- “Nationwide cannot recoup expenditures made in fulfilling its promises to defend pursuant to the reservation-of-rights letters. It was in Nationwide's own interest to provide a defense under the reservation of rights . . . to avoid exposure had the court held it did have a duty to defend . . . In the absence of a policy provision . . . or active assent to the reservation by the (policyholders), the reservation of rights letters were not enough to impose a burden on the (policyholders) to reimburse Nationwide.”
Principles Underlying the “New Majority” View

1. Reservation of Rights letters cannot be used to create “unilateral contracts”

2. CGL policies (unlike D&O policies) generally do not include language allowing insurers to obtain “reimbursement”

3. “Reservation of Rights” has its benefits for insurers, but to receive benefit, insurer has to take on risk

4. All reward and no risk for insurer is not a just result

5. Insurer agreement to defend evidences potential for coverage
Other "New Majority" View Opinions

1. **American and Foreign Insurance v. Jerry’s Sport Center**
   (Pennsylvania Superior Court)

2. **Pekin Ins. Co v. TYSA, Inc.**
   (S.D. Iowa)

3. **St. Paul & Marine Insurance v. Holland Realty**
   (D. Idaho)

4. **Employers Mutual Casualty v. Indus. Rubber Products**
   (D. Minn.)

5. **General Star Indemnity v. Virgin Islands Port Authority**
   (D.C. V.I.)

6. **Westchester Fire Insurance v. Wallerich**
   (8th Cir.)
How Can Policyholders Protect Themselves?

1. Expressly object

2. Reject the “majority” view argument - it simply is not accurate

3. Even if insurer made no payments after agreeing to defend, “new majority” view should require insurer to pay for amounts incurred before court rules against duty to defend
Biography

Linda Kornfeld is the Managing Partner of Dickstein Shapiro’s Los Angeles office and a partner in the Insurance Coverage Practice. Ms. Kornfeld conducts an active trial and appellate practice, representing insureds in complex litigation matters. She also provides insurance risk management advice to her clients with respect to policy procurement and renewals. She has substantial litigation and trial experience, and has handled major insurance coverage matters for a wide range of clients nationally, including in California, Delaware, New York, Michigan, and Texas. According to Chambers USA: America’s Leading Lawyers for Business, Ms. Kornfeld and fellow partner Kirk Pasich “are the best attorneys in California when you have a claim against an insurance company.” Ms. Kornfeld also has been recognized by Business Insurance on its list of the top 50 “Women to Watch” in the insurance industry. The Daily Journal named her as one of California’s top 100 women litigators, and Southern California Super Lawyers named her as one of Southern California’s top 50 women lawyers.

Ms. Kornfeld also is involved in women’s leadership issues and engages in activities to promote the advancement of women into leadership positions in the legal and other professions. In fact, she is a frequent speaker and writer on the subject. “Women Leaders Boost Profit,” an article co-authored by Ms. Kornfeld, appeared in the September 2006 issue of Barron’s. Ms. Kornfeld maybe reached at kornfeldl@dicksteinshapiro.com.