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In This Issue

Leadership Note

Long Tail Toxic Tort SLG

By Ricardo Woods

The Long Tail Toxic Tort Substantive Law Group enjoyed the numerous networking opportunities and top notch programming provided during the Insurance Coverage & Claims Institute this past April in Chicago. The event consistently offers defense lawyers from parts all over the entire DRI network the ability to conduct meaningful exchanges of practical ideas designed to assist clients in the insurance industry.

In addition to wonderful speaking opportunities DRI's Insurance Law Committee also offers opportunities to publish articles about the industry. *Covered Events* allows DRI members to share their experience, expertise and insight with over 2,800 Insurance Law Committee members. In the very near future the Long Tail Toxic Tort SLG is looking forward to publishing content regarding issues associated with contaminated ground water and we are looking for submissions. If you are interested in writing on this topic, please contact me at rwoods@burr.com.

Ricardo Woods is a defense trial lawyer at Burr & Forman, LLP in Mobile, Alabama. He is vice chair of the DRI Diversity and Inclusion Committee and vice chair of the Insurance Committee's Long Tail Toxic Tort SLG. He has extensive experience defending owner controlled insurance cases and defending toxic tort claims.

Note from the Editor

From the Editor

By Shanda K. Pearson

Thank you for taking a break from your summer festivities to tune into *Covered Events*. In addition to summaries on recent case law across the nation, this issue contains an interesting article contributed by G. Patrick HagEstad, "*Draggin' Y:* Is the Confessed Judgment Door Open?"

Please continue to keep *Covered Events* in mind when you see a new court decision in which ILC members may have an interest—you can submit a case summary to any one of the Covered Events editors for potential inclusion in an upcoming issue. Also, if you are interested in writing a featured article for an upcoming edition of Covered Events, please contact your ILC substantive law subcommittee chair for more details.

Finally, even though we've not yet reached the middle of summer, it is time to start thinking about fall and making plans to attend DRI's Annual Meeting. This year's meeting is scheduled for October 16 through 19 at the New Orleans Marriott Hotel. The meeting offers a week of spectacular keynote speakers, cutting-edge CLE presentations, and many networking events that will give you a chance to meet fellow DRI members and enjoy the food, music and fun that New Orleans provides. Click here to download the brochure and submit your registration.

Featured Article

Draggin' Y: Is the Confessed Judgment Door Open?

By G. Patrick HagEstad

It is hard to imagine anything more chilling on the risk management and insurance side of the equation than hearing the words "the plaintiffs and the insureds have stipulated to a judgment in excess of policy limits." Many are familiar with stipulated or confessed judgments as a consequence of declining to defend an insured under the policy. But, an even more ominous risk is the push for acceptance of confessed judgments relating to alleged insurer breaches other than the duty to defend—even when a vigorous defense was provided. Several states have now taken a look at whether an insured can stipulate to a judgment without the consent of the insurer, with a covenant not to execute against the insured's assets and an agreement to assign all of the insured's potential claims against the insurer to the plaintiffs, where the insurer is providing a defense but is alleged to have breached some other duty to its insured. The Montana Supreme Court is the latest court to struggle with this issue in *Draggin' Y IV. Draggin' Y Cattle Co., Inc. v. Junkermier, Clark, Campanella, Stevens, P.C.*, 2019 MT 97, 439 P.3d 935 ("*Draggin'Y IV*"). *Draggin' Y IV* is an example of what types of duties are at issue and a harbinger of things to come.

Many experienced lawyers and insurers are more familiar with the confessed judgment in the duty to defend context. Confessed judgments in duty to defend cases provide a stark contrast to confessed judgments in other contexts because the insurer has determined that the claims against the insured are not covered and therefore no obligation to defend the insured is triggered. While confessed judgments in both situations are based upon principles of breach of contract and the "abandonment" of an insured by its insurer, it is much easier for an insured to point to a lack of a defense as an alleged abandonment than when there is a disagreement on some other alleged policy duty, especially when a defense was provided. In cases where the insured denies a duty to defend, there is a bright line and the insured faces a lawsuit without the protection of the defense.

Draggin' Y IV is the latest case to take up this discussion. While the Montana Supreme Court ultimately determined that a confessed judgment is not enforceable in Montana where the insurer did not breach its duty to defend, the concurring opinion seemed to fully argue that any material breach of the insurance contract should be grounds for allowing insureds to confess judgments. *Id.*, & 43. The arguments and issues raised by *Draggin' Y IV* have already been reviewed in several states and it is likely to continue to spread as the policyholder's bar hones the arguments and theories as to why alleged abandonment in the "other" duty context can be every bit as devastating to an insured as in the duty to defend context.

Draggin' Y IV is helpful and instructive in illuminating these issues so coverage counsel and the insurer keep them in mind throughout the pendency of a case. It is becoming increasingly clearer that an insurer cannot just make a determination on coverage, hire defense counsel, and then assume it can defend until the fact finder makes a determination. Whether an insured may allege abandonment occurred in cases where the insurer's obligation to defend is fulfilled will depend on the alleged duty involved and the circumstances of each case.

Draggin' Y IV can be an exemplar of issues that may potentially lead to an allegation of "abandonment" by an insured and set the stage for an argument that a confessed judgment was appropriate due to the insurer's breach of various duties other than the duty to defend. These include policy limits demands in cases that seemingly do not rise to that level, the use of overly aggressive tactics by the plaintiff's counsel including use of reptilian tactics, and the use of other tactics designed to create conflicts between the insurer and the insured—all in situations where the law and the facts do not seem to warrant such an effort.

The Pre-Suit Factual Background

The claims in *Draggin' Y* were derived from a failed 1031 exchange. Draggin' Y's accounting firm advised the exchange would work to defer several million dollars in taxes to a later date. *Draggin' Y Cattle Co., Inc. v. Addink, et al.*, 2013 MT 319, ¶ 11, 372 Mont. 334, 338, 312 P.3d 451, 455 ("*Draggin' Y I*"). Draggin' Y's lawyer, however, after advising the plaintiff that the exchange was a related party transaction and would not work to defer the taxes but would instead trigger an immediate taxable gain on the properties of several million dollars, disclaimed this advice, deferred to the accountants, and prepared all the closing documents. *Id.*, ¶¶ 8–9. After the transaction had closed,

the accountant learned at a seminar that, despite the particular way this transaction was structured, it would not qualify for the deferred tax treatment under section 1031. *Id.*, ¶ 10.

The accountant then notified Draggin' Y that several million dollars of tax would immediately be due with the next tax filing but advised of a plan to completely mitigate the tax. *Id.*, ¶¶ 11–12. By reorganizing the company to take advantage of tax losses in the cattle ranch operations, they were able to mitigate 100 percent of the tax leaving only the penalties and interest as potential actual damages in the case. Further, under this plan, the properties that were acquired in the 1031 exchange could also be sold tax free because once the taxes were mitigated on the transaction, the new properties had the step up in basis of the actual purchase price instead of the artificially lower basis they would have carried if the taxes had merely been deferred under the exchange. *Id.*, ¶¶ 12–13.

The Procedural Background and Settlement

Draggin' Y filed its complaint against the accountant and his firm in 2011. *Draggin' Y IV*, 2019 MT at ¶ 8. New York Marine and General Insurance Company retained counsel to defend both, and the defense filed summary judgment on several legal issues. *Id.*, ¶¶ 8, 13. However, in spite of the full tax mitigation, *Draggin' Y* made a demand indicating their damages exceeded the limits but that they would accept limits to settle the case. Based upon the policy limits demand, both defendants hired separate counsel to represent them in the issues created by the policy limits demand. *Id.*, ¶ 11. Independent counsel for each defendant demanded settlement within policy limits or an admission by the insurer that it would cover any excess judgment, if any. *Id.*, ¶¶ 11–12.

New York Marine denied the policy limits demand. A settlement conference failed. *Id.*, ¶ 15.

The day before defendants' summary judgment motions were set for hearing, the insureds settled with Draggin' Y for a stipulated judgment of $10,000,000, with a covenant not to execute on the assets of the insured but only against the insurer. *Id.*, ¶ 16. The insurance policy limit was $2,000,000–$8,000,000 less than the stipulated judgment. *Id.*, ¶ 10.

The District Court ruled the settlement was reasonable and enforceable against the insurer over the insurer's objections. *Id.*, ¶ 18. The case was appealed and was remanded in part for a determination of reasonableness. *Draggin' Y Cattle Co., Inc. v. Addink, et al.*, 2016 MT 98, ¶¶ 1–2, 383 Mont. 243, 244, 371 P.3d 970, 971 ("*Draggin' Y II*"); *Draggin' Y Cattle Co., Inc. v. Junkermier, Clark, Campanella, Stevens, P.C.*, 2017 MT 125, ¶¶ 1–2, 395 P.3d 497, 431–32 ("*Draggin' Y III*"). Ultimately, the case made it back to the Montana Supreme Court to consider whether a stipulated judgment was reasonable against an insurance company that met its obligation to defend. *Draggin' Y IV*, 2019 MT at ¶ 24.

On this fourth appeal, New York Marine objected to the reasonableness of the stipulated judgement. *Id.*, ¶ 1. Draggin' Y and the accountants (the insureds) were all now represented by the same counsel—Draggin' Y's counsel from the underlying action.

Draggin' Y's Arguments in Favor of Enforcement

Draggin' Y maintained on appeal that the confessed judgment was appropriate even though New York Marine did not breach its duty to defend because "other" duties arising from the insurance contract are every bit as important to the insured as the duty to defend. Draggin' Y claimed other duties such as the duty to settle within policy limits, the duty to carefully and forthrightly represent the policy terms, and the duty to put the insured's interests above the insurer's interests, when breached, could also amount to an abandonment of the insured no different from the duty to defend.

The Issues and Arguments on Appeal

The issues on appeal are illustrative of the types of issues that insureds may raise to argue abandonment giving them the right to self-help in the form of a stipulated judgment. These issues are relevant for anyone insuring or defending a highly contentious case.

The court styled the issues in *Draggin' Y IV* as follows:

> [W]e address whether the District Court properly found the settlement agreement reasonable when the insurer provided a defense under a reservation of rights throughout the relevant proceedings, but did not confirm coverage under the policy or file a declaratory action to determine coverage, declined to settle with Plaintiffs for policy limits, and misrepresented the policy limits.

Draggin' Y IV, 2019 MT at ¶ 2.

While acknowledging that the case was not a duty to defend case, the District Court had held that an abandonment of an insured can result in an enforceable stipulated settlement even if a defense was provided where the insurer failed to confirm or deny coverage within a reason-

able time or to settle a case in good faith. *Id.*, ¶ 18. "The District Court surmised that when an insurer fails to fulfill these requirements, 'it's abandonment of its insured is just as certain as if it has breached the duty to defend.'" *Id.*

At that point, the table was set. The District Court distilled the case law on enforceability of stipulated settlements down to one conclusion—whether the facts and circumstances of the case supported a finding of abandonment. Under this rubric, all the District Court had to do was determine whether New York Marine "abandoned" the accountants by misrepresenting the policy, defending under reservation of rights, failing to file a declaratory action, or failing to settle under the circumstances. In the District Court's assessment, it had. *Id.*

On Appeal, New York Marine argued that only a breach of the duty to defend could result in an enforceable stipulation and that it had defended throughout. *Id.*, ¶ 20. It also disputed that it failed to affirm coverage or that good faith required settlement. In addition, it disagreed that even if it had failed in those respects, such conduct amounted to abandonment. *Id.*

For its part, Draggin' Y admitted that New York Marine defended the case. "They contend[ed], though, that New York Marine violated other duties under the insurance contract, the 'constellation' of which resulted in the abandonment of [the insured] . . . 'just as certain as if it ha[d] breached the duty to defend.'" *Id.* ¶ 21. As a result, it was reasonable for the insured to enter into the stipulation to protect itself. *Id.* In other words, duties other than the duty to defend in the policy, if breached, either alone or in conjunction with other breaches by the insurer, could rise to the level of abandonment justifying the insured's decision to enter into a confessed judgment.

Draggin' Y IV: The Holding

The Supreme Court of Montana re-framed the issue to "whether an insurer 'improperly abandons its insured,' justifying the insured 'in taking steps to limit his or her personal liability' by entering into a confessed judgment, assignment of rights, and covenant not to execute that gives rise to a presumption of reasonableness, when the insured alleges the insurer breached contractual or statutory duties other than the duty to defend." *Draggin' Y IV*, 2019 MT at ¶ 21 (citing *State Farm Mut. Auto. Ins. Co. v. Freyer*, 2013 MT 301, ¶ 34, 372 Mont. 191, 312 P.3d 403).

The Court was being asked to determine whether abandonment could occur in relation to an alleged breach of duties owed by an insurer aside from the duty to defend. In justifying disparate treatment, the Court focused on the distinction between the impact of the duty to defend and the duty to indemnify. In its assessment, the duty to defend requires immediate action and a denial of a duty to defend results in immediate consequences for the insured. If an insurer does not defend its insured, it should not be able to "put on that defense for its own benefit in later proceedings." *Id.*, ¶ 25.

In contrast, in the Court's opinion, issues relating to the duty to indemnify are typically "interpretational questions that often require legal opinions and separate declaratory actions to determine." *Id.*, ¶ 24 (citing *Freyer*, ¶ 37). If a defense is undertaken, and the insured "might have prevailed at trial had the insured and the claimants not settled without the insurer's participation, no presumption of the insured's liability generally arises from the fact or amount of settlement." *Id.*, ¶ 25 (internal citations omitted).

Ultimately, the Court likened Draggin' Y's breach of duty allegations to an alleged breach of the duty to indemnify. *Id.*, ¶ 24. Since there were other claims and remedies available to Draggin' Y under contract law and statutory law, Draggin' Y's allegations did not amount to abandonment but rather potential claims against the insurer. *Id.*, ¶ 32. The Court reasoned that allowing confessed judgments in non-duty to defend cases would allow the insured to make unilateral decisions about these potential future claims without a trier of fact determining the facts or judge declaring the law. *Id.*, ¶ 30. In contrast, the denial of a defense provides a bright line. It occurred or it didn't and the consequences are plain and evident immediately.

The real risk in confessed judgment cases is the argument set forth in the *Draggin' Y IV* concurring opinion. In the concurring opinion, Justice Sandefur seemed to indicate that if it were up to him he would have approved a holding to allow any material breach of the insurance contract to form the basis of a confessed judgment. *Id.*, ¶ 42. He went on to explain his opinion that abandonment should not be the focus but whether any material breach had occurred under contract law—a much lower standard. *Id.*, ¶ 43.

What Can Be Learned from *Draggin' Y IV* in Other Jurisdictions

This article was not written so much as a case brief as it was an illustration of the serious risks facing insurers that, as the law develops, could result in jurisdictions considering the enforceability of confessed judgments outside situations where the insured has denied its duty to

defend. While *Draggin' Y IV* dealt with the duty to settle in good faith, the duty to affirm or deny coverage, the duty to fairly represent coverages and policy limits, and all while providing a defense under a reservation of rights, insureds will likely attempt to use other policy duties and obligations to establish abandonment or "material breach" under the law of any given jurisdiction to justify and enforce a confessed judgment. In Montana, those issues were decided by reliance on existing case law, Montana's heavy preference for a bright line respecting the duty to defend, the fact that the defendants could have prevailed at trial, and the fact that there were other remedies and claims available to the insured that were not as drastic as a confessed judgment. Each jurisdiction is different and has different priorities. Every case has its own nuances and factual circumstances. This provides a lot of opportunities for plaintiff's counsel to play in the grey areas.

We can use *Draggin' Y* and similar cases, however, to identify issues early and carefully manage them so they do not turn into support for an argument of abandonment. It is prudent to be aware of these issues and develop strategies to mitigate the risks in any given case.

Certain Circumstances Warn of Potential Abandonment or "Material Breach" Claims

Wildly Different Views on Liability and Damages Between the Parties

In *Draggin' Y IV*, the two sides were very far apart on valuation of the case damages. Draggin' Y was demanding millions of dollars and asserting damages in excess of $12,000,000. *Draggin' Y IV*, 2019 MT at ¶ 14. The insurer valued the case at $100,000–$350,000 if plaintiff were able to survive summary judgment. *Id.*, ¶¶ 15–16. One party viewed the case as well within policy limits and one viewed the case as an excess case. One party viewed the case through the lens of liability being reasonably clear and the other viewed it as a case that could be resolved on summary judgment briefing.[1]

The tension created by these divergent views led to the allegation of a breach of the duty to settle in good faith and, indirectly, to arguments concerning an alleged duty to affirm coverage of potential excess verdicts.

When wildly different assessments of the legal issues and factual issues are combined with a policy limits demand, an almost perfect storm is generated if a confessed judgment can be based simply on an insurer's decision not to pay the limits demand.

Reservation of Rights Letters

Reservation of rights letters, while preserving an insurer's rights under a policy, may create other issues that need to be considered such as representations of the coverage provided by the policy, representations on limits, and representations on the applicability of multiple policies. In the right circumstances and jurisdictions, a reservation of rights can create conflicts between the insured and the insurer that complicate litigation and claims handling allowing for an allegation that the insured has been abandoned as seen in *Draggin' Y IV*. *Draggin' Y IV*, 2019 MT at ¶¶ 18, 21.

There are already instances in which courts have held an insurer defending under a reservation of rights liable for whatever settlement the insured enters into. *See United Servs. Auto. Ass'n v. Morris*, 154 Ariz. 113, 115, 741 P.2d 246, 248 (1987) (involving an agreement entered into after reservation of rights by insurer; liability insurer filed action seeking declaration that it was not obligated to pay $100,000 judgment and court ruled that insurer was liable for reasonable portion of judgment in some circumstances); *Kelly v. Iowa Mut. Ins. Co.*, 620 N.W.2d 637 (Iowa 2000) (administrator of estate brought suit against insurer defending under reservation of rights in wrongful death action and trial was reversed and remanded for finding of whether insurer rejected reasonable settlement offer); *Patrons Oxford Ins. Co. v. Harris*, 905 A.2d 819 (Me. 2006) (automobile liability insurer sought declaratory judgment against settlement made by insured driver with injured party while defending under reservation of rights; court ruled that settlement was binding only if reasonable); and *Martin v. Johnson*, 141 Wash. App. 611, 170 P.3d 1198 (2007) (purchasers of home brought action against estate of vendor, seeking damages resulting from a leaking underground oil tank and the court found the settlement made to be reasonable even though insurer defended under reservation of rights).

The Demand Within Limits

A demand within limits of the policy can also trigger a whole host of issues and conflicts between the insurer and the insured. Given the propensity for large damage claims, this category has the potential to be the most prolific of the battlegrounds for confessed judgments. In *Draggin' Y IV* the allegation was that the insurer had an obligation to settle the case within policy limits to protect the insured from any potential excess verdicts or at least to provide the

[1] The case settled the day before the hearing on the summary judgment motions filed by the insured.

insured a letter agreeing to extend limits to that of any verdict actually reached in the case. *Draggin' Y IV*, 2019 MT at ¶¶ 14, 21. Such a demand can also be used as a wedge to separate the tripartite relationship of insured, insurer-hired defense counsel, and the insurer. To prevent such conflicts, it might be necessary for the insurer and the insured to hire separate counsel to work through the issues between them so defense counsel can continue advising the insured on the litigation at hand without worry of where defense counsel's loyalty lies—to the insured or the insurer.

The insured's counsel will likely focus on the mere fact that a policy limits demand was made to conclude a duty to settle was created. Insurers will focus on whether the demand was reasonable in light of existing laws and the circumstances of the case as was done in *Draggin' Y IV*. Even if confessed judgments can be upheld in the duty to settle within limits context, they should have some limits such as where there is a reasonable or serious risk of an excess judgment under the law and facts of the case. Unreasonable demands should not be the trigger.

Under California law, when deciding whether to settle a claim, an insurer must take into account the interests of the insured as in many states. *See Hamilton v. Maryland Cas. Co.*, 27 Cal. 4th, 718, 724, 41 P.3d 128, 132 (2002). The *Hamilton* Court held that confessed judgments should not be relevant to a damages determination because there was no trial. *Id.* at 725, 730; *Wolkowitz v. Redland Ins. Co.*, 112 Cal. App. 4th 154, 162, 5 Cal. Rptr. 3d 95, 103, 104 (2003). This logic was followed in an Arizona opinion allowing confessed judgments if a reasonable policy limit demand was made and the insurer did not settle. *Safeway Ins. Co. v. Guerrero*, 210 Ariz. 5, 9, 106 P.3d 1020, 1024 (2005). *See also United Servs. Auto. Ass'n v. Morris*, 154 Ariz. 113, 741 P.2d 246 (1987). In Washington an insurer fell victim to a confessed judgment when defending under a reservation of rights in *Martin v. Johnson*, 141 Wash. App. 611, 170 P.3d 1198 (2007). The court reasoned that "[a]n insurer that is disputing coverage cannot compel an insured to forego a settlement that is in his or her best interests." *Id.*

Conclusion

Two things can both be true at the same time. We are a nation of laws dependent on precedent. We also know that the more things change, the more they stay the same. It is only a matter of time until cases and challenges like *Draggin' Y IV* percolate through other jurisdictions pushing the law even further to recognize and ratify confessed judgments in ever widening circumstances.

The duty to defend may be the most acceptable foundation of enforceable confessed judgments at the moment, but in time we could see more "material breach" arguments regarding other duties allegedly owed by an insurer. Montana opted for a bright line test based upon its very specific bad faith and statutory laws, but not every state can rely on that.

Insurers and their counsel can, and should, be mindful of these issues early on in cases or they too might be hearing the words "the plaintiffs and the insureds have stipulated to a judgment in excess of policy limits."

G. Patrick HagEstad is a 1998 graduate of the University of Tulsa College of Law with honors. He is AV Preeminent rated by his peers at the highest level of professional excellence and ethics. Mr. HagEstad is licensed to practice in Montana and Arizona. He is a Shareholder and a Managing Member with Milodragovich Dale & Steinbrenner P.C. His practice focuses on the defense of extra-contractual/bad faith liability, professional liability, and complex litigation matters. Mr. HagEstad is a member of the DRI and its Insurance Law, Commercial Law, Product Liability and Professional Liability Committees, the Professional Liability Defense Federation (PLDF), the Montana Defense Trial Lawyers Association (MDTL), the American Bar Association (sections: tort, trial and insurance practice, business law, health law, real property, probate and trust law), the Western Montana Bar Association, State Bar of Montana and State Bar of Arizona. Mr. HagEstad is also a Harmonie Group Vice Liaison for Montana.

Recent Cases of Interest

First Circuit

D&O / "Claims Made" / Related Claims (MA)

The First Circuit affirmed a Massachusetts court's ruling that a D&O insurer had no duty to defend an SEC enforcement action brought during the policy period in light of evidence that it was related to administrative orders and subpoenas that were entered before the policy period. In ruling that these claims were not "first made" during the policy period, the court in *Biochemix, Inc. v. AXIS Reinsurance Company*, No. 17 2059 (1st Cir. May 23,

2019), held that these were related claims. According to the court, it was sufficient that there was a "substantial overlap" between the earlier and later claims; the policy's Inter-Related Wrongful Acts provision did not require that they be identical. Morrison Mahoney's Bill Schneider represented AXIS.

Michael Aylward
Morrison Mahoney

Second Circuit

Late Notice / Waiver

New York State Electric & Gas v. Century Indemnity Company (2d Cir. Apr. 25, 2019).

Second Circuit holds for Carriers in Dispute Over Late Notice of Contamination and Remediation Claims, Rejecting Insured's Waiver Argument.

New York State Electric & Gas (NYSEG) investigated and remediated contamination at nearly two dozen former manufactured gas plant sites over the course of many years. Starting in the early 1980s, the New York State Department of Environmental Conservation was involved in the remediation, as was the United States Environmental Protection Agency. There was significant contamination at many of the plants and NYSEG incurred considerable costs over time. At one point, they notified their insurance carriers and requested indemnification in relation to the various contamination occurrences. Those carriers, including Century and OneBeacon, disclaimed coverage on several bases, primarily late notice, and litigation ensued.

At issue before the Second Circuit was whether the carriers had waived the right to assert the late notice defense. In particular, the insured claimed a draft disclaimer letter, that had been crafted but never sent, showed one of the carriers waived that defense by not timely raising it. However, this argument failed to hold water, the court held, because to demonstrate waiver a party must "put forward evidence of a clear manifestation of intent to waive" a known right. The letter was not only never sent, but the draft was incomplete, clearly a copy/paste from another disclaimer letter, and never reviewed before a coverage determination was made. In the case of such facts, it could not be said that the carrier was lulled into sitting on its rights. Moreover, the carrier did not have complete copies of the old policies until the start of litigation, so it could not have known the full facts sufficient to warrant waiver.

Rather, what was clear was that the insured provided categorical late notice of the claims. They knew at least from the start of the 1980s about the various occurrences and remediation efforts, particularly in light of the fact that governmental agencies were involved and left a long paper trail. Thus, their notice was untimely as a matter of law.

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Fourth Circuit

Duty to Cooperate (MD)

The Fourth Circuit ruled a professional liability insurer is bound by a default judgment entered against an insured physician after he fled the United States. Although defense counsel had withdrawn from the case because he concluded that Maryland's rules of professional responsibility barred him from defending a case without a consenting client, the Fourth Circuit agreed with the U.S. District Court that neither ethical rules, nor Maryland law or the terms of the Lancet policy prevented Lancet from defending the malpractice action. In *Mora v. Lancet Indemnnity Risk Retentiion Group*, No. 18-1566 (4th Cir. May 7, 2019) (unpublished), the court interpreted the "right and duty" language in this policy as giving "advanced consent" by the insured to its insurer's right to defend. The court also faulted Lancet for not consulting with other lawyers before accepting the conclusion of appointed defense counsel and withdrawing from any further effort to defend its absentee insured. Finally, the court declared that Lancet had failed to show it was prejudiced by any failure to cooperate on the part of its insured.

Michael Aylward
Morrison Mahoney

Fifth Circuit

NFIP / Statute of Limitations (TX)

The U.S. Court of Appeals for the Fifth Circuit ruled a Texas District Court did not err in granting summary judgment to a property insurer in light of the homeowner's failure to bring suit within the 1-year statute of limitations. In *Cohen v. Allstate Ins. Co.*, No. 18-20330 (5th Cir. May 17, 2019), the court emphasized that any party seeking recovery pursuant to the National Flood Insurance Program "must comply strictly with the terms and conditions that Congress has

established for payment" including the relevant limitations period for asserting a claim.

Michael Aylward
Morrison Mahoney

Trigger of Coverage (MS)

Travelers Indem. Co. v. Mitchell, --- F.3d ---, 2019 WL 2276694 (5th Cir. May 29, 2019).

The U.S. Court of Appeals for the Fifth Circuit held that two insurers must provide a defense to their insured in a wrongful conviction suit. In the underlying case, the families of three deceased men, who were wrongfully imprisoned, brought suit against Forrest County, Mississippi for wrongfully coercing the men into confessing to a murder they did not commit. Forrest County tendered the suit to its insurers (the "Insurers"), which refused to provide a defense on the grounds that Forrest County's wrongful acts took place before the law enforcement liability policies at issue were in effect.

The U.S. District Court for the Southern District of Mississippi held that, regardless of when Forrest County's wrongful conduct took place, the Insurers had a duty to defend because the three men suffered physical and emotional injuries during the relevant policy periods. On appeal, the U.S. Court of Appeals for the Fifth Circuit affirmed the judgment of the trial court, reasoning that while the wrongful convictions took place before the subject policies were issued, the resulting injuries occurred during the policy periods. Specifically, the appellate court stated that "[b]ecause the estates' complaint alleges those injuries during the relevant time periods, both insurers have a duty to defend Forrest County and its officers[.]" Therefore, the Insurers were required to provide a defense to Forrest County.

Charles W. Browning
Elaine M. Pohl
Patrick E. Winters
Plunkett Cooney

Seventh Circuit

Environmental / Expert Testimony (IL)

The Seventh Circuit ruled that an Illinois District Court did not err in striking the testimony of a geologist who gave unfounded "expert" testimony denying that releases of pollutants from the diesel refueling area of the insured's facility had been "sudden" or "accidental." In *Varlen Corp. v. Liberty Mutual Ins. Co.*, No. 17-3212 (7th Cir. May 16, 2019), the Seventh Circuit agreed with the district court that the expert's testimony was "nothing more than guesses" and had been properly stricken as being unreliable and speculative in violation of FRE 702.

Michael Aylward
Morrison Mahoney

Intentional Acts Exclusion (IL)

The Seventh Circuit ruled in *Le Than Tran v. Minnesota Life Ins. Co.*, No. 18-1723 (8th Cir. April 29, 2019), that an insured's suicide arising out of a botched "auto-erotic asphyxiation" was excluded from coverage under a life insurance policy in light of an "intentionally self-inflicted injury" exclusion.

Michael Aylward
Morrison Mahoney

Eighth Circuit

Total Pollution Exclusion / "Dispersal" (MN)

Claims against a restauranteur for selling contaminated recycled fat that a pork producer used to manufacture animal feed have been declared to arise out of the "dispersal" of a pollutant. In *Restaurant Recycling LLC v. Employers Mut. Cas. Co.*, No. 17-2792 (8th Cir. April 29, 2019), the Eight Circuit declared that Minnesota law does not require that the dispersal be intentional and that it was sufficient in this case that at least one of the impurities in the fat caused property damage.

Michael Aylward
Morrison Mahoney

Auto / UIM (MO)

The Eighth Circuit affirmed a Missouri district court's declaration that an incident in which the insured was shot by a drive-by vehicle did not arise out of the use or operation of an uninsured vehicle. In *Patel v. LM General Ins. Co.*, No. 18-2035 (8th Cir. May 3, 2019), the court adopted numerous decisions of the Missouri Court of Appeals that declared uninsured vehicles are not in "use" merely because they are the situs of tortious conduct and rejected the insured's argument that these rulings are in conflict with *Schmidt v. Utilities Ind. Co.*, 182 S.W.2d 181 (Mo. 1944).

Michael Aylward
Morrison Mahoney

Tenth Circuit

Bad Faith

Thomas v. Farmers Insurance Company (10th Cir. May 17, 2019).

The Thomases owned a home in Sand Springs, Oklahoma, for over thirty years. On December 14, 2012, the Thomases' homeowner's insurance policy issued by Farmers became effective. This insurance policy contained an earthquake endorsement that protected the home against certain damage caused by earthquakes. On November 12, 2014, a 4.9 magnitude earthquake (the "2014 Earthquake") struck Conway Springs, Kansas, which is approximately 112 miles from Sand Springs. Two days later, Jodi Thomas noticed that the slab floor in a utility closet was broken and had collapsed four inches. She suspected that the 2014 Earthquake caused the damage and reported the damage to her Farmers agent.

Farmers investigated, and ultimately denied the claim because the damage was not caused by earthquake activity. Farmers denied the claim a second time after the Thomases sent additional documentation and engineering reports concerning the damage to their home because the damage to the home was determined to not be caused by an earthquake.

While Farmers twice told the Thomases that it denied coverage under the insurance policy because the damage was not caused by earthquake activity, at trial Farmers gave a different reason for its denial. At trial, Farmers argued for the first time that an earlier earthquake in 2011 (the "2011 Earthquake") caused the damage to the Thomases' home. The 2011 Earthquake was a 5.3 magnitude earthquake that struck near Prague, Oklahoma, which is 55 miles from the Thomases' home in Sand Springs, Oklahoma.

On appeal, the Thomases argued that by changing its rationale for denying the claim Farmers acted contrary to Oklahoma bad faith case law. Under Oklahoma law, a claim for bad faith in the insurance context turns on whether the insurer had a good faith belief, at the time its performance was requested, that it had a justifiable reason for withholding payment under the policy. To determine the validity of the claim, the insurer must undertake an investigation that is reasonably appropriate under the circumstances. Accordingly, the focus of a bad-faith claim is the knowledge and belief of the insurer during the time period the claim is being reviewed.

Thus, under Oklahoma law an insurance bad faith claim is premised on the actual reason the insurance company gave when it denied the claim, not a post-denial rationalization. Therefore, evidence that supports a post-denial rationalization, rather than the evidence that the insurance company actually relied on when initially denying a claim, is inadmissible.

The 2011 Earthquake was never the reason Farmers gave when it denied the Thomases' claim. In fact, Farmers expressly stated in both denial letters that the damage to the property was not caused by earthquake activity at all. However, the Thomases never objected at trial when Farmers presented its new rationale for denying the claim. Thus, this argument wasn't preserved. Even if it had been, the court noted that the Thomases' own expert conceded that, under a United States Geological Survey earthquake scale, the surface impact of the 2014 Earthquake near the Thomases' home was II or III ("weak") and the potential damage expected from a level II or III earthquake under the scale is "none."

Accordingly, the jury's verdict in favor of Farmers on the bad faith count was affirmed.

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Eleventh Circuit

E&O / "Professional Services" (FL)

The Eleventh Circuit refused to give malpractice coverage to a counselor who was sued for giving care that he was neither certified or qualified to render. In an unpublished opinion, the Court of Appeals ruled in *Chapman v. ACE American Ins. Co.*, No. 18 12972 (11th Cir. May 21, 2019), a drug abuse counselor was alleged to have contributed to the suicide of a young patient that he was counseling for AHDH and other mental health problems. The court emphasized that under Florida law, mental health counseling and substance abuse counseling are treated as distinct professions governed by different statutes, licensing and training. In this case, the definition of "professional services" in the Ace policy was defined as meaning drug and alcohol abuse counseling whereas the claims against the insured were for his alleged negligence in providing mental health counseling. Furthermore, the insured lacked the required licensure, education or experience to provide mental health counseling. As a result, the Eleventh Circuit

agreed with the Florida District Court that the underlying claims were not for "professional services."

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Standing / Class Actions (FL)

Having agreed to reconsider its original opinion, the Eleventh Circuit has now ruled in *A&M Gerber Chiropractic, LLC v. GEICO General Ins. Co.*, No, 17-15606 (11th. Cir. May 30, 2019), that a lower court erred in allowing a chiropractic clinic to pursue an assigned claim against GEICO for refusing to pay the $10,000 statutory limit for PIP benefits in Florida. In light of the fact that GEICO had paid its insured over $7,000 despite the fact that he was only entitled to recover $2,500 since he had not received "emergency medical care," the court declared that the insured had not suffered any damage as the result of GEICO's claims handling and that his assignee therefore lacked standing to bring a putative class action against GEICO.

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Alabama

Construction Claims / "Occurrence"

The Alabama Supreme Court ruled that a trial court erred in requiring a liability insurer to defend construction defect claims against a building contractor. In *Nationwide Mut. Fire Ins. Co. v. The David Group, Inc.*, No. 1170588 (Ala. May 24, 2019), the court ruled that the underlying complaint solely sought recovery for defective construction and the insured had failed to present any evidence of allegations that the property owner had suffered damage to their personal property or other resulting damage beyond the insured's faulty workmanship.

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California

Bad Faith / Punitive Damages

The California Court of Appeal ruled in *Mazik v. GEICO Ins. Co.*, B281372 (Cal. App. May 17, 2019), that there was sufficient evidence to sustain a million dollar award of punitive damages in a bad faith case. Notwithstanding GEICO's argument that the evidence at trial was insufficient to show that any "officer, director or managing agent" had engaged in acts that were oppressive, fraudulent or malicious, the Second District declared that the involvement of supervisory employees at GEICO satisfied the requirements of Section 3294 and that the amount of punitive damages (three times the insured's actual loss) was constitutionally appropriate.

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Illinois

Independent Counsel / Punitive Damages

The Illinois Appellate Court ruled that an insured was entitled to independent counsel where its insurer was reserving rights based on a punitive damages exclusion and the claim for punitive damages was the greatest part of the insured's exposure. In *Xtreme Protection Services LLC v. Steadfast Ins. Co.*, 2019 IL App (1st) 181501 (Ill. App. Ct. May 3, 2019), the First District concluded that "where punitive damages form a substantial portion of the potential liability in the underlying action and Steadfast disclaims liability for punitive damages, Xtreme is left with the greater interest and risk in the litigation. Therefore, a conflict of interest exists, entitling Xtreme to obtain independent counsel paid for by Steadfast." The Appellate Court also rejected Steadfast's claim that Xtreme had breached the duty to cooperate, declaring that telling defense counsel not to take any actions that impeded its defense had not caused prejudice to Steadfast and therefore did not bar coverage based upon a breach of a condition to coverage.

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Iowa

Bad Faith

De Dios v. Indem. Ins. Co. of N. Am., --- N.W.2d ---, 2019 WL 2063289 (Iowa May 10, 2019).

The Supreme Court of Iowa held that state law does not recognize a cause of action for bad faith against a third-party claims administrator responsible for adjusting claims on behalf of a workers' compensation insurer. The plaintiff, an injured employee who suffered a work-place injury, brought suit against his employer's workers' compensation carrier as well as the third-party claims administrator who adjusted the claim. The Supreme Court of Iowa initially recognized that "the predominant justification for recognizing a bad-faith tort against workers' compensation carriers was the existence of certain 'affirmative obligations' placed upon them by our statutory and regulatory scheme." According to

the Supreme Court, however, such statutes did not impose "'affirmative obligations' on third-party administrators as they do on insurers." The Supreme Court observed that the Legislature did not define "insurer" to include "third-party administrators," which "shows that our [L]egislature recognized a distinction between insurers and third-party administrators, and opted to impose 'affirmative obligations' only on the former." The Supreme Court ultimately ruled that "the nondelegable duties imposed by Iowa statutes and administrative regulations remain on the carrier regardless of any attempt to pass them to a third party."

Charles W. Browning
Elaine M. Pohl
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Montana

Consent Judgments

The Montana Supreme Court ruled that a trial court erred in sustaining a $10 million consent judgment in a case that a professional liability insurer had been defending under a reservation of rights. Whereas the trial court had ruled that the insurer's failure to settle was equivalent to a breach of the duty to defend and that, having been "abandoned" by its insurer, the insured was to settle over the insurer's objections, the Supreme Court ruled in *Draggin' Y Cattle Co. v. Junkermeier, Clark, Campanella, Stevens, PC*, 2019 MT 97 (Mont. April 24, 2019), that the claimants' remedy against an insurer for failure to settle was a statutory claim for bad faith under the Montana UTPA. However, the court went on to hold that it was improper for the court below to make a finding that the underlying $10 million consent judgment was both reasonable and enforceable in this case, where the insurer was defending. Rather, in such cases there is no presumption of reasonableness and the claimant must itself establish that the settlement was fair and reasonable. Three justices joined in a concurring opinion in which they argued that New York Marine had a full and fair opportunity to challenge the reasonableness of the settlement amount and should not be permitted to relitigate that issue on remand.

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New Jersey

Auto / PIP Coverage

A narrowly divided Supreme Court has ruled that there is no evidence that the Legislature meant to deviate from the rule that plaintiffs cannot introduce evidence of medical expenses in excess of a driver's PIP limits when it amended New Jersey's no fault insurance regime to permit motorists to purchase PIP limits that were far lower than the original $250,000 default amount. In the absence of such evidence, the majority declared in *Haines v. Taft*, A-13 (N.J. May 1, 2019), that it could not conclude that the legislature had meant "to deviate from the carefully constructed no-fault first-party PIP system of regulated coverage of contained medical expenses and return to fault-based suits consisting solely of economic damages claims for medical expenses in excess of an elected lesser amount of available PIP coverage. Unless the Legislature makes such an intent clearly known, the Court will not assume that such a change was intended by the Legislature through its amendments to the no-fault system in the Automobile Insurance Cost Reduction Act." Justice Allen filed a dissenting opinion, arguing that N.J.S.A. 39:6A-12 is intended to prevent a double recovery of damages, not to deny an automobile accident victim a just recovery of damages and that the majority's interpretation of the statute will have a catastrophic impact on the right of low-income automobile accident victims to recover their medical costs from the wrongdoers who cause their injuries.

Michael Aylward
Morrison Mahoney

Ohio

Assault and Battery Exclusion

Jerome Badders v. Century Ins. Co., 2019-Ohio-1900, 2019 WL 2156625 (Ohio App. May 17, 2019).

The Ohio Court of Appeals held that an assault and battery exclusion plainly applied to preclude coverage to Jerome Badders (Badders), the owner of a bar, for personal injuries to Tatyana Belenky (Belenky), a bar patron, that took place when Marvin Schalk (Schalk), another bar patron, drove his truck through the front of the building shortly after the bar closed. The policy at issue excluded coverage for personal injury or property damage "arising out of or resulting" from "any actual, threatened or alleged assault or battery[.]" Badders asserted that the trial court erred in concluding that the exclusion applied to preclude coverage as a matter of law because there was a genuine issue of material fact

regarding whether Schalk intended to injury Belenky when he drove his truck through the front of the building.

The appellate court disagreed with Badders' argument, concluding that the plain meaning of the term "assault" was "[a]n attack or violent onset, whether by an individual [person], a company, or an army." In other words, the term "assault" in the exclusion included both the common law tortious definition as well as the criminal definition. Accordingly, the appellate court determined that "the exclusion of coverage for personal injuries and property damage 'arising out of or resulting' from 'any actual, threatened or alleged assault or battery' unambiguously applies to exclude coverage for personal injuries and property damage that result from any legally cognizable form of assault, without respect to whether the assault is criminal or tortious."

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Pennsylvania

Coverage B / "Advertising"

A federal district court ruled that allegations that an ice cream manufacturer sold its products through kiosks and containers that copied those of a competitor triggered a duty to defend under a CGL policy. Despite Liberty Mutual's contention that none of these claims arose out of the insured's advertising and were therefore subject to an intellectual property exclusion in its policy, Judge Conner declared in *Hershey Creamery Co. v. Liberty Mutual Fire Ins. Co.*, No. 18-694 (M.D. Pa. May 6, 2019), that he was not required to decide whether signage inside the insured's stores constituted "advertising" because the underlying allegations did not preclude any possibility of coverage and therefore must be defended. The court observed that "broad claims for trademark infringement..., which generally allege improper use by Hershey of f'real's trademarks in Hershey's competing slogans—quite naturally could include infringement in advertising as well as in packaging and displays."

Michael Aylward
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South Dakota

"Damages" / Tripartite Claims

A federal district court asked the South Dakota Supreme Court to declare whether the cost of an insured tearing down their house pursuant to a court injunction are "damages" covered under a liability policy. In *Sapienza v. Liberty Mut. Fire Ins. Co.*, 2019 U.S. Dist. LEXIS 84973 (D.S.D. May 17, 2019), the District Court separately adopted the "inadequate defense" theory of liability set forth in Section 12 of the ALI Restatement of Law, Liability Insurance, declaring that Liberty Mutual might be liable for overriding the advice of the insured's own chosen counsel and refusing to engage an independent expert architect or contractor to support the insured's defense. While concluding that the insured's factual allegations failed to sustain a finding of liability on this basis, the District Court allowed the insured an additional 14 days to supplement its claims. The court did dismiss the insured's bad faith claims, ruling that the decisions the insured alleged to have hindered the defense were not support by the facts alleged and were unrelated to the allegedly "deficient" defense that the insurer had provided.

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Duty to Defend / Bad Faith

In one of the first cases to rely on the ALI's Restatement of Law, Liability Insurance, a federal district court has predicted that the South Dakota Supreme Court would adopt Section 12's rule that a liability insurer may be sued for providing an "inadequate defense." In *Sapienza v. Liberty Mutual Fire Ins. Co.*, No. 18-3015 (D.S.D. May 17, 2019) , the insured had argued that Liberty Mutual breached the duty to defend by taking over the defense of the lawsuit and countermanding the independent judgment of defense counsel, failing to retain necessary experts, and refusing to pay for certain defense activities. Despite having ruled that a cause of action for "inadequate defense" might be claimed, the District Court dismissed the insured's breach of contract claim, declaring that the factual allegations set forth in this count were mere "naked assertions devoid of further factual enhancement" and therefore fell afoul of the *Twombly* standard for motions to dismiss. The District Court declined to dismiss the insured's claim that Liberty Mutual owed coverage for $60,000 that they had incurred to demolish their home in response to an order finding that it was in violation of height and set back restrictions and agreed to certify the question of whether complaint

with orders for injunctive relief are "damages" under South Dakota law.

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Virginia

Absolute Auto Exclusions

The Virginia Supreme Court ruled in *James River Insurance Company v. Doswell Truck Stop LLC*, No. 180624 (Va. May 16, 2019), that a trial court erred in failing to rule that an incident in which a truck stop customer was fatally injured when a tire that was being installed on his tractor trailer exploded was excluded from coverage as arising out of the "maintenance" of "any" auto. Whereas the trial court had ruled that "maintenance" was ambiguous because it could either mean "regular repair operations" or a "possessory interest other than ownership or use of an auto," the Supreme Court found that "regular repair operations" was the only reasonable interpretation of "maintenance" that could reasonably be applied to every instance of the term in the James River policy. The Supreme Court went on to declare that the exclusion applied since the underlying injuries clearly "arose out of maintenance of the vehicle." The Supreme Court rejected the insured's argument that the exclusion should not apply to alternative theories of liability such as the insured's negligence in allowing a customer into an area where he was exposed to a dangerous condition.

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Wisconsin

Crime Coverage / Forgery / "Directions to Pay"

The Wisconsin Supreme Court ruled in *Leicht Transfer & Storage Company v. Pallet Central Enterprises, Inc.,* 2019 WI 61 (Wis. May 31, 2019), that sums a shipping company paid under false pretenses after a vendor provided them with forged delivery tickets fell outside the scope of a commercial crime policy issued by Hiscox. Whereas the insured had argued that these forged delivery tickets comprised "directions to pay" within the meaning of the "forgery or alteration" coverage terms, the Supreme Court declared that the delivery tickets were merely evidence of deliveries and did not contain any terms requiring the insured to pay a sum certain. Rather, the court found in this case that an invoice is a request for payment, not a "direction to pay." Justice Bradley dissented, arguing the majority's opinion ignored the standard business practices of the parties and conflicted with the insured's reasonable expectations of coverage.

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