



Risking It All

WHEN IS A BUSINESS INSURED FOR INTENTIONAL ACTS?

THE RISK MANAGER'S MOST SIGNIFICANT FUNCTION WITHIN THE OPERATION IS TO PLAN FOR DISASTER, THEN INSURE AGAINST IT. SO HOW DOES THE RISK MANAGER ANTICIPATE AND INSURE AGAINST INTENTIONAL CONDUCT BY THE COMPANY AND ITS EMPLOYEES?

David E. Wood, Shareholder ANDERSON KILL WOOD & BENDER, P.C.

For any risk manager, the worst nightmare is a loss that — despite the risk modeling, despite the careful planning of risk transfers and despite having placed a high-quality set of insurance programs — falls into some unforeseen gap in coverage. Every time the risk manager thinks he or she has anticipated all reasonably foreseeable losses, another scenario raises its head and forces everybody back to a planning mode. The only way to anticipate and prevent gaps is planning, planning and more planning. Indeed, the risk manager's most significant function within the corporation is to plan for disaster, then insure against it.

Anticipating and Insuring Against Intentional Conduct

How does a risk manager anticipate and insure against intentional conduct by the company and its employees? Purely intentional acts are not

covered by insurance. Most states have statutory or common-law prohibitions against insuring acts undertaken intentionally, with the intent to cause harm. Society simply does not permit a gross wrongdoer to profit by shifting financial responsibility for inherently bad acts to an insurance company. That is why commercial general liability (CGL) policy forms exclude losses that are “expected or intended from the standpoint of the insured,” and why employment practices liability insurance (EPLI), directors and officers (D&O) and errors and omissions (E&O) policies have provisions excluding proven dishonest or fraudulent conduct. These inherently culpable acts do not qualify to be insured, and therefore are referred to as uninsurable.

But sometimes CGL policies do allow alleged bad actors to shift to insurers the expense of defending them — and even the expense of paying settlements or judgments. The difference between

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uninsurable intentional conduct and insurable intentional conduct can be hard to identify and anticipate, creating a gap into which some losses can — unforeseeably — fall.

Insurable vs. Uninsurable Intentional Conduct

CGL policies have two parts. The first part, called Coverage Part A (or something similar), covers bodily injury and property damage caused by an “occurrence,” usually defined as something sudden and accidental. The second part, Coverage Part B, covers the corporate policyholder for third-party suits alleging wrongful or misleading advertising.

Coverage Part B also covers the policyholder when it is sued for “personal injury,” defined as suits alleging malicious prosecution, wrongful entry to or eviction from land, false imprisonment, slander or invasion of privacy. These offenses are inherently intentional, and yet they are insurable. By contrast, Coverage Part A makes clear that it responds only to negligent, unintentional acts by covering only liabilities of the insured for accidentally causing someone bodily injury or property damage, and by excluding losses caused intentionally.

Say a fight breaks out at a restaurant and the operator drags the instigator into a back room, demanding that he calm down before he can be released. When eventually he is allowed to go, he complains of chest pain and later collapses and dies. If his surviving family sues the restaurant operator for intentionally harming the unruly patron in an effort to stop the fight, the insurer will point to the absence of an “occurrence” and to the expected or intended exclusion, and will not

provide a defense. But if the same family sues the operator for false imprisonment — even intentional false imprisonment — the carrier will reserve the right to deny indemnity (coverage for a settlement or judgment) if a jury finds that the policyholder intentionally injured the deceased patron, but it will provide a defense.

What’s the difference? Why are the same allegations of intentional acts excluded under Coverage Part A but covered under Coverage Part B? If not all intentional conduct is uninsurable, where will the insurer draw the line? And how can the policyholder anticipate what intentional conduct will be covered and what will be excluded?

‘Four Corners’ and ‘Extrinsic Evidence’ States

The answer may depend upon the state in which the claim arises. States have two ways of determining whether the duty to defend is triggered when an intentional act is alleged.

In a “four corners” state, the carrier has a duty to defend if there is an allegation of potentially covered conduct within the four corners of the complaint. In the example above, the patron’s family framed its lawsuit against the restaurant operator in terms of intentional conduct. As a result, if they file this complaint in a four corners state, the operator will not be covered — even if there is evidence that it did nothing intentional or wrongful at all.

In an “extrinsic evidence” state, the opposite result would happen. There, the insurer cannot rely solely upon what is alleged in the complaint to decide whether it has a duty to defend. If there is evidence outside of the four corners of the complaint that suggests the policyholder — if it is at fault at all — caused the bad result (death of the patron) accidentally rather than intentionally, the carrier must defend. The policyholder often is the source of this evidence.

Here, if the operator points to evidence not alleged in the complaint, such as the incident report showing that the employees who moved the patron to the back room took great care to assure he was not injured, this creates the possibility that the operator — again, if it is at fault at all — committed negligent rather

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than intentional acts. Because the carrier must defend if there is the barest potential for coverage found in the complaint augmented by extrinsic evidence, it has a duty to defend in this example.

Therefore, in four corners states such as Tennessee and Colorado, an allegation of strictly intentional conduct is uninsurable, while in an extrinsic evidence state like California or Maryland, the same allegation is insurable — and triggers a duty to defend — assuming there is some evidence that the insured might have acted unintentionally. Whether the restaurant operator receives a defense in the deceased patron example will depend on where the restaurant is located.

Defend and Indemnify Duties

A CGL policy contains two duties: the duty to defend and the duty to indemnify. The duty to defend has a hair trigger, and attaches when there is a potential for coverage. The duty to indemnify, referring to its duty to pay a settlement or judgment, attaches only if the settlement or judgment is caused (by a preponderance of the evidence) by a covered offense. Because the duty to defend is broader than the duty to indemnify, an insurance company may have a duty to defend a policyholder against allegations that it committed a potentially covered act, but not ultimately have any duty to pay a settlement or judgment. This distinction often drives the extent to which intentional acts are insurable.

Insurable intentional torts (like false imprisonment) are general intent torts. If the actor intends the act (here, confining another without right), then it doesn't matter whether he or she intended any harm. The actor's general intent is enough to establish the elements of the tort. False imprisonment, therefore, is an insurable intentional act — so long as no specific intent is pleaded (in four corners states) or proven (in extrinsic evidence states).

In a four corners state, where false imprisonment is claimed without any allegation of specific intent to harm, the carrier has a duty to defend and the act is insurable. But the minute an assertion that the policyholder intended the harm is added, the resulting specific intent tort is not insured

and the insurer has no duty to defend. Extrinsic evidence states are more forgiving, requiring the carrier to at least provide a defense to an assertion of specific intent if there is evidence outside the complaint of the insured's lack of such intent. Yet even in extrinsic evidence states, if the evidence ultimately shows that the insured specifically intended the plaintiff harm, the loss is uninsurable and the carrier will be barred by law from indemnifying it.

Retail businesses that deal closely with the general public sometimes purchase assault and battery coverage by endorsement to their CGL policies or as a stand-alone coverage, essentially adding it to the list of torts enumerated in Coverage Part B. This add-on typically covers defense costs only, or defense costs subject to a low indemnity sublimit. This structure reflects what underwriters usually consider the intent of intentional acts coverage under CGL policies: to respond primarily as a defense coverage, with less emphasis on indemnity.

Getting the Most from Your CGL Policy

This intent is not always consistent with policy language. To get the most from a CGL policy, when faced with a lawsuit that claims the company did something inherently intentional, ask the following questions:

Is the alleged tort called out in the CGL policy's coverage grants?

Coverage Part A: Does plaintiff allege an act that, but for the intentional conduct allegation, would otherwise be covered (e.g., bodily injury or property damage, no applicable exclusion)?

Coverage Part B: Does plaintiff allege one of the torts enumerated in the insuring agreement (malicious prosecution, wrongful entry to or eviction from land, false imprisonment, slander or invasion of privacy) without an applicable exclusion?

Was the alleged tort committed in a four corners or extrinsic evidence state?

Four corners: If the answer was no to both parts of the first question above, and plaintiff's suit alleges strictly intentional conduct, then the insurer has no duty to defend or indemnify. This

will remain so unless plaintiff amends to allege some otherwise covered, unintentional act.

Extrinsic evidence: If the answer was yes to both parts of the first question above, and no evidence extrinsic to the complaint indicates the possibility of unintentional conduct, then the insurer has a duty to defend.

If the case is resolved by settlement, is the insured able to show by a preponderance of the evidence available for trial that if it is held liable, liability will be for a general intent tort (i.e., covered) rather than a specific intent tort (i.e., not covered)?

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If yes, and the tort is otherwise covered (i.e., the answer to one or both of the first questions is yes), then the insurer must indemnify the settlement. If the tort is not otherwise covered, then it need not do so.

If no, then there is no indemnity obligation.

If the case is resolved by adverse judgment at trial, does a preponderance of the evidence show liability for a general rather than specific intent tort (assuming no general or special verdict form answering this question directly)?

If yes, then the insurer likely must indemnify the judgment, although it may take another round of litigation to establish what the facts were leading to the general verdict (a good way to keep open the option of arguing a general intent tort, absent a punitive damages award).

If no, then the insurer need not indemnify the judgment, and may under some circumstances be able to recover reimbursement of defense costs from the policyholder. ▲

