Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

# Policyholders Bag Big Victories In The First Half Of 2013

By **Bibeka Shrestha**

*Law360, New York (June 28, 2013, 8:51 PM ET)* -- Policyholders have chalked up major wins at the New York Court of Appeals and the Illinois Supreme Court this year, clinching rulings that widen coverage for defense costs, statutory damages and disgorgement losses, while excess insurers are cheering the Second Circuit for shielding their policies from being triggered early.

Here are some of the 2013 insurance decisions that are already making waves.

**K2 Investment Group v. American Guarantee & Liability Insurance Co.**

New York's top court delivered **a heavy blow** to insurers with a June 11 decision that threatened grim punishment for carriers that wrongly refuse to defend policyholders.

The New York Court of Appeals ruled that because American Guarantee & Liability Insurance Co. had violated its duty to defend, it could no longer hold up policy exclusions to avoid covering a $3.1 million malpractice judgment — even if those exclusions would otherwise have saved it from covering an underlying judgment or settlement, the high court said.

The court warned it would be unjust to force policyholders who were wrongly abandoned by their insurers to later battle it out in court over whether policy exclusions saved carriers from covering their judgments and settlements.

Randy Maniloff, a White and Williams LLP attorney and author of the insurance law newsletter Coverage Opinions, told Law360 the decision will be monumental in New York.

The K2 ruling will push insurers to defend more cases and bring more declaratory judgment actions in court to fight coverage for cases they took on out of an abundance of caution, according to Maniloff.

"It will be a cloud that hangs over insurers as they are making duty to defend decisions," Maniloff said.

According to Laura Foggan, a Wiley Rein LLP partner who represents insurers, the holding is a major one because it's a sharp departure from the view that insurers that breach their defense obligations are responsible only for covering defense costs or damages directly caused by the breach.

"Denying the insurer the right to rely on policy exclusions is overbroad and unfairly punitive," Foggan said. "Adequate remedies exist at law for an insurer's breach of contract."

But policyholder attorneys are hailing the decision for raising the stakes and making clear that carriers should not take their duty to defend lightly. The Court of Appeals said explicitly the ruling will give insurers an incentive to defend the cases they are bound by law to defend.

"The court got it right and put those incentives just where they belong," said Carl Salisbury, a partner at Kilpatrick Townsend & Stockton LLP.

John Nevius, a shareholder at Anderson Kill & Olick PC, noted that Connecticut has recognized the rule set out in K2 since the 1960s.

"You waive your coverage defense to indemnity if you fool around with the duty to defend," Nevius said. "The duty to defend has no value if it can be called into question too easily."

The case is K2 Investment Group v. American Guarantee & Liability Insurance Co., case number 106, in the Court of Appeals of the State of New York.

**Mehdi Ali et al. v. Federal Insurance Co. et al.**

While they may be reeling from the K2 decision, insurers can rest a little easier on another front **thanks to the Second Circuit**. The federal appeals court on June 4 held that Federal Insurance Co. and Travelers Casualty and Surety Co.'s excess policies could not be triggered until the full policy limits of the underlying insurance were paid.

It stressed that a 1928 decision that policyholders have long leaned on to trigger excess policies did not apply to the directors and officers coverage dispute with Federal and Travelers because it was handed down in a case involving a property policy, rather than a liability policy. On top of that, the court noted that Zeig v. Massachusetts Bonding & Insurance Co. was decided under a freestanding federal common law that no longer exists.

Angelo Savino, a member of Cozen O'Connor, said the decision is one of the most important ones handed down this year for distinguishing the precedent in Zeig, which let a Manhattan dressmaker win excess coverage for a burglary even though primary insurer paid less than its policy limit to settle the claim.

Policyholders have long turned to Zeig to press excess insurers to fill in a coverage gap that results when a lower-level insurer pays less than its policy limit or when these insurers become insolvent and can no longer pay.

"It undermines the Zeig case as precedent for gap-filling," Savino said. "It will make it easier for excess carriers to enforce the language in their policies regarding when their policy is triggered."

Brian Osias, a partner at McCarter & English LLP, criticized the Second Circuit's decision as being unreasonable from a commercial standpoint and for defying what he saw as good policy.

"The holding provided a windfall to the excess insurer and penalized the insured for settling, something which is supposed to be judicially favored," Osias said. "Discouraging settlements in this manner is simply not good public policy."

The case is Mehdi Ali et al. v. Federal Insurance Co. et al., case number 11-5000, in the U.S. Court of Appeals for the Second Circuit.

**Standard Mutual Insurance Co. v. Lay**

Earlier this year, the Illinois Supreme Court **gifted policyholders** with a powerful weapon when it held that damages under the Telephone Consumer Protection Act are insurable because they are not punitive, putting a lid on a defense often put forward by insurers.

The May 23 ruling gave policyholders a big leg up in securing coverage for the $500 in damages awarded to plaintiffs for each violation of the TCPA, a law that Congress passed in 1991 to combat junk faxes, robocalls and other telemarketing-related annoyances.

The Illinois high court found that even if consumers that have received junk faxes may not have suffered a grave amount of damages, the $500 per violation does compensate them for the loss of ink and paper and other harms. The steep figure also encourages private parties to enforce the statute, showing the liquidated damages could not be merely punitive, the ruling said.

According to Salisbury, carriers almost always argue that those damages were designed to punish violators and that they cannot be footed by insurers, and some courts have accepted that defense. To have the Illinois Supreme Court side with policyholders on the hard-fought question is a major victory, he said.

"Other courts often look to its decisions for persuasive authority," Salisbury said. "I think this decision will have some influence and impact on how other states look at the question."

Maniloff said the impact of the Standard Mutual ruling will reach beyond coverage cases dealing with just TCPA damages. There are other statutes on the books that allow for liquidated damages that are higher than the actual amount of harm caused, Maniloff said.

"I would expect to see Lay cited by policyholders in these cases, in support of their argument that such liquidated damages are not penal, and, therefore, not excluded from coverage, in a state that otherwise disallows coverage for punitive damages," Maniloff said.

The case is Standard Mutual Insurance Co. v. Lay, case number 2013-IL-114617, in the Supreme Court of the State of Illinois.

**JPMorgan Securities Inc. et al. v. Vigilant Insurance Co. et al.**

On the same day it handed down the K2 ruling, the highest court in New York issued **a surprising decision** letting Bear Stearns & Co. Inc. pursue insurance coverage for part of its $160 million in losses even though payment was labeled as "disgorgement" by the U.S. Securities and Exchange Commission.

The New York Court of Appeals recognized that other courts have held that carriers don't have to cover a company for its return of ill-gotten gains, because it would violate public policy to cover those kinds of losses. But it pointed out that Bear Stearns was claiming in its own lawsuit that $140 million of the "disgorgement" payment it made to the SEC represented improper profits that its hedge fund customers pocketed, not Bear Stearns' own revenues.

Allowing Bear Stearns' suit to go forward, the high court held that the SEC's order did not establish that the entire $160 million disgorgement payment represented money that Bear Stearns itself illegally earned through late trading and market timing activities.

The ruling makes clear that insurers can't avoid covering disgorgement losses if a policyholder did not profit from allegedly ill-gotten gains, according to Jared Zola, a partner at Dickstein Shapiro LLP.

"Insurers always say no coverage for disgorgement, period," Zola said. "This is a huge ruling."

The case is JP Morgan Securities v. Vigilant Insurance, case number 113, in the New York State Court of Appeals.

--Editing by John Quinn and Jeremy Barker.