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Risk Radar
Hot Topics to Watch in the Coming Months

Indiana

Wellpoint Inc. v. National Union Fire Insurance Co., 952 N.E.2d 254 (Ind. App. 2011)

In Wellpoint, the Indiana Court of Appeals limited the ability of insurance companies to use notice and limitation of liability clauses as substitutes for prior claims exclusions in claims-made-and-reported policies.

As part of its program to reinsure itself against errors and omissions liability, Anthem Insurance Company bought an excess policy from the Twin City Fire Insurance Company for the period from July 2000 through September 2002. In November 1999, a group of physicians brought a class action suit against an Anthem subsidiary alleging that it failed to timely and adequately reimburse them for medical services, among other things. From February 2001 through June 2004, a series of 10 state and federal lawsuits were brought against Anthem containing similar allegations concerning reimbursement. Anthem sought defense and indemnification under the Twin City's policy in connection with four of the latter suits.

Twin City denied coverage of the four suits on grounds that the policy's limitation of liability and notice provisions deemed the four suits made and reported at the time of the original suit in November 1999, before the Twin City policy incepted. Anthem brought an action against Twin City for breach of contract and Twin City counterclaimed for declaratory relief. The trial court ruled in favor of Twin City and Anthem appealed.

The Indiana Court of Appeals reversed the trial court, holding that the Twin City policy covered the four latter suits against Anthem. With respect to the limitation of liability provision, the court held that it served two prospective purposes: 1) protecting the insurance company from "paying out excessively" for continuous, repeated or interrelated behavior, and 2) enabling the policyholder to receive coverage for claims made after the expiration of the policy. Similarly, the court found that the notice provisions equally lacked language indicating a retrospective, exclusionary intent. In the absence of such language, the court was unwilling to permit either of these provisions from acting as the equivalent of a prior notice exclusion.

In the wake of *Wellpoint*, policyholders may see more prior notice exclusions in claims-made-and-reported policies. Until that happens, *Wellpoint* serves as an effective counterpoint to aggressive efforts by insurance companies to restrict the scope of coverage afforded by their D&O and E&O policies.

Fourth Circuit

Bryan Brothers Inc. v. Continental Cas. Co., 419 Fed.Appx. 422 (4th Cir. 2011)

Professional liability policies frequently exclude coverage for claims arising out of dishonest or illegal acts or omissions to the extent that the policyholder engaged in, or knew about such acts. These exclusions are tempered by exceptions preserving coverage for those policyholders having no knowledge of those acts or omissions. In *Bryan Brothers*, the Fourth Circuit called into question whether such exceptions afford much in the way of coverage for the policyholder when those acts take place over a span of time.

Bryan Brothers purchased a professional liability policy from Continental Casualty for the period from July 1, 2008, through July 1, 2009. The policy's insuring clause covered liability of policyholders and its officers or employees in connection with the performance of professional services – "provided that," prior to the inception of the policy, "none of [them]" had reason to believe such act or omission might reasonably be expected to the basis of a claim (the "prior knowledge provision"). The policy also contained a "bad acts exclusion" for claims based on acts or omissions determined to be illegal or fraudulent, but was modified by an "innocent insureds provision" preserving coverage for policyholders that had no knowledge of such acts.

In February 2009, Bryan Brothers discovered that its account clerk had embezzled funds from the accounts of eight clients from 2002 through the inception of the policy period. The victims asserted tort claims against Bryan Brothers. Bryan Brothers tendered its defense to Continental Casualty, which denied coverage on the basis of the prior knowledge provision, not the bad acts exclusion. Bryan Brothers settled the claims, then brought suit against Continental Casualty. The District Court granted Continental Casualty's motion for summary judgment and Bryan Brothers appealed.

The Fourth Circuit affirmed the trial court's ruling. It held that the prior knowledge provision's use of the phrase "provided that," amounted to a condition precedent to coverage. Because the account clerk was an employee of Bryan Brothers, her knowledge of her own acts – though concealed from everyone else – was deemed sufficient to trigger the prior knowledge provision and preclude any coverage of the embezzlement claims. The court effectively discarded the innocent policyholder provision as inapplicable because Continental Casualty did not deny coverage on the basis of the bad acts exclusion to which that provision applied.

Bryan Brothers stands as a stark reminder that insurance companies can and do use broad prior knowledge exclusions to counteract coverage otherwise clearly contemplated by "innocent insureds" provisions.

Texas

Downhole Navigator, L.L.C. v. Nautilus Ins. Co., 2011 WL 4889125 (S.D.Texas 2011)

In *Downhole*, the policyholder, an oil drilling company, was sued for negligence for its role in causing damage to an oil well. The policyholder sought coverage for the lawsuit from its insurance company, Nautilus. But Nautilus sent a reservation of rights letter stating:

> Nautilus Insurance Company will provide your company with a defense to these claims. However, Nautilus reserves all rights to disclaim any duty to indemnify for claims and judgments which fail to seek "damages" under the policy, as further set forth below.

Nautilus also identified three exclusions that it contended would defeat coverage.

Because of Nautilus' position, the policyholder rejected defense counsel chosen by Nautilus, fearing that insurance company-appointed counsel could steer the lawsuit toward uncovered damages. The policyholder argued that the facts to be decided in the underlying lawsuit were the same facts that could potentially defeat coverage. Thus, the policyholder claimed that insurance company-controlled defense counsel had a conflict of interest, hired its own independent counsel, then sought reimbursement for its defense costs.

Unfortunately for the policyholder, the magistrate judge deciding cross-motions for summary judgment decided there was no conflict and that the policyholder was not entitled to reimbursement. The court reasoned that the lawsuit alleged that the driller was negligent, and negligence was not an issue on which coverage depended. In essence, the court ignored the policyholder's argument that the conflict existed due to the various forms of damage, some of which would be covered and some not.

This case is now on appeal before the Fifth Circuit Court of Appeals. If upheld, it would represent a step backward in the trend around the country toward protecting a policyholder from the risk that insurance company-appointed defense counsel, whose loyalties run primarily to the insurance company that pays their bills, will subtly – or not so subtly – steer the defense effort toward a noncovered result.

Washington

National Surety Corp. v. Immunex Corp.,
162 Wash.App. 762 (2011)

Immunex was sued for allegedly inflating the prices of its drugs. Immunex tendered the claims to its insurance company, National Surety. National Surety issued a reservation of rights letter under which it agreed to pay for Immunex's defense costs, but reserved its right to seek reimbursement of those defense costs should a court determine that coverage for the claims did not exist.

National Surety then filed a declaratory judgment action seeking a ruling that it had no obligation to cover the claims made against Immunex. National Surety was awarded declaratory judgment, then sought reimbursement of the defense costs it had paid on behalf of Immunex.

In a victory for policyholders, the court held – in a case of first impression – that National Surety was not entitled to reimbursement since its policy did not explicitly allow it to seek this relief. The court refused to read such language into the policy. In addition, the court refused to view the payment of Immunex's defense costs as recoverable under a theory of unjust enrichment, since payment of these costs benefited National Surety and was not "purely a gratuity to the insured." The court therefore determined that National Surety was required to pay Immunex's defense costs up to the time the court in the declaratory judgment action ruled there was no coverage.

This decision protects the right of a policyholder to a defense whenever there is a bare potential for covered loss, up to the moment the insurance company proves that no such potential exists. Had the insurance company embedded a right to reimbursement in its policy, however, this decision might have gone the other way. But watch this space: the Washington Supreme Court granted National Surety's petition for review, and oral argument took place on May 8, 2012.

Utah

United States Fidelity and Guarantee Co. v. United States Sports Specialty Assoc., 2012 WL 192793, – P.3d – (2012) – Supreme Court of Utah

In another case addressing an insurance company's "right to reimbursement", the Supreme Court of Utah answered a certified question of Utah state law from the United States District Court for the District of Utah: when does an insurance company have a right to reimbursement or restitution against a policyholder? The court concluded that Utah law allows a right to reimbursement from its policyholder only when the right is expressly provided in the insurance agreement.

This action arose from an underlying personal injury case where the verdict exceeded the policy limits by $4 million. The insurance company, USF&G, settled the matter after the verdict for a payment of $4,825,000 which exceeded the $2 million policy limits. Over its policyholder's objections, USF&G settled the matter under a "unilateral reservation of rights" claiming it could seek reimbursement for the excess amount from its policyholder.

When USF&G sought reimbursement from its policyholder for the overpayment based on alleged right to restitution, the Supreme Court of Utah determined that Utah law does not allow an insurance company to seek reimbursement or restitution through an extracontractual claim of unjust enrichment. Instead, the court held that "an insurer's right to reimbursement from an insured must be expressly provided in an insurance policy before it can be enforced."

In this case and in *National Surety* above, the courts rejected the insurance companies' argument that, allowing the policyholder to retain the benefit of an insurance company-funded defense unless and until the insurance company proved there was no coverage, was unjust and inequitable. Decisions like these may prompt some insurance companies to add contractual reimbursement provisions to their policies, much as D&O insurance company's added "relative exposure" allocation provisions to their policies in the wake of mid-1990's court decisions rejecting allocation in many cases in which insured directors and officers were sued jointly with non-insured entities.

Oregon

State Farm Fire and Cas. Co. v. American Family Mut. Ins. Co., 242 Or.App.60 (2011)

If the underlying complaint fails to allege "property damage," does this excuse an insurance company from its duty to defend its policyholder? In State Farm, the underlying plaintiffs sued the policyholder for the insured's shoddy construction work in building a home. But the complaint asserted claims against the policyholder for "failing to complete work and performing shoddy work." Defendant American Family denied coverage, arguing that the underlying complaint failed to allege "property damage," defined as "physical injury to property" or "loss of use of uninjured tangible property."

The Court of Appeals of Oregon agreed, holding that where the underlying plaintiffs fail to specifically allege property damage or injury to property covered by the defendant-insurance company's policy, the defendant-insurer had no duty to defend. This decision underscores the importance of locating some qualifying example of property damage resulting from an occurrence, even where the bulk of the dispute concerns construction deficiencies – which may trigger a duty to defend even if the settlement or judgment ultimately is not covered.

About Anderson Kill & Olick, P.C.

Anderson Kill practices law in the areas of Insurance Recovery, Commercial Litigation, Environmental Law, Estate, Trusts and Tax Services, Corporate and Securities, Antitrust, Bankruptcy, Real Estate and Construction, Anti-Counterfeiting, Employment and Labor Law, Captives, Intellectual Property, Corporate Tax, Health Reform and International Business. Recognized nationwide by Chambers USA for Client Service and Commercial Awareness, and best-known for its work in insurance recovery, the firm represents policyholders only in insurance coverage disputes – with no ties to insurance companies and has no conflicts of interest. Clients include Fortune 1000 companies, small and medium-sized businesses, governmental entities, and nonprofits as well as personal estates. Based in New York City, the firm also has offices in Ventura, CA, Stamford, CT, Washington, DC, Newark, NJ and Philadelphia, PA.