PRESERVING COVERAGE DEFENSES:

KEY CONSIDERATIONS FOR INSURERS AND THEIR ATTORNEYS WHEN EVALUATING THE DUTY TO DEFEND

Please note that the diverse viewpoints expressed here and during the presentation are solely those of the individual presenters and do not necessarily reflect those of their employers, any affiliated entities, or partners.
PRESERVING COVERAGE DEFENSES

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WHAT IS ESTOPPEL?

Derives from the law of equity

Legal principle prevents party from asserting otherwise valid legal rights due to its conduct

Would be unjust for those rights to be asserted
WHAT IS ESTOPPEL?

In the context of the duty to defend:
If the insurer breaches the duty, the estoppel doctrine may preclude the insurer from raising policy defenses to coverage.
Estoppel: Breach of Duty to Defend May Require Insurer to Cover Otherwise Uncovered Damages

In all states, an insurer that wrongfully refuses to defend is liable for the insured’s reasonable defense expenses.

In some states, an insurer that wrongfully refuses to defend or improperly discharges its duty to defend also loses the right to raise some or all coverage defenses.
The Estoppel Doctrine Varies from State to State

Estoppel not recognized in all states

Conduct that gives rise to estoppel not the same in all states

Rights lost by insurer to deny coverage not the same in all states
When Can Estoppel Arise?

- Improper denial of coverage – failing to assume the defense.
- Wrongful defense refusal and unreasonable delay in bringing dj action.
- Failure to advise of conflict and to offer independent counsel where conflict exists.
- Control of defense and directing action of defense counsel where conflict exists.
When Does Estoppel Not Arise?

No duty to defend = no risk of estoppel.

No coverage or potential for coverage.

Person/entity tendering is not an Insured.

No insurance policy in existence for occurrence or claim.

Insurer not given opportunity to defend.
Consequences of Breaching the Duty to Defend in Various States

Insurer potentially estopped from raising coverage defenses if it breaches duty to defend:


• **CT** – *Black v. Goodwin, Loomis & Britton*, 681 A.2d 293 (Conn. 1996) (insurer forfeits coverage defenses – up to policy limits)

• **MT** – *Swank Enters. Ins. v. All Purpose Servs.*, 154 P.3d 52 (Mont. 2007) (if insurer unjustifiably refuses to defend, it’s estopped from denying)

• **WA** – *Underwriters at Lloyd’s v. Denali Seafoods*, 927 F.2d 459 (9th Cir. 1991) (insured must prove actual prejudice for estoppel to apply)
Consequences of Breaching the Duty to Defend in Various States

Payment of attorneys’ fees incurred in underlying action:

- AL, AR, CO, DE, HI, ID, IA, KS, KY, LA, ME, MD, MA, MI, MN, MO, NE, NH, NY, OK, OR, PA, UT, WA, WV

Payment of defense costs and indemnity up to policy limits:

- AZ, CA, FL, GA, MS, MT, NJ, ND, OH, RI, SC, SD, TN, TX, VT, VA
Consequences of Breaching the Duty to Defend in Various States
The Estoppel Doctrine - Illinois

Breach of the duty to defend occurs when there is:

• Improper denial of coverage (e.g. failing to assume the defense)

Under Illinois law, potential consequences of breach of duty to defend include:

• Breach of contract damages for attorneys fees and costs incurred in defending the underlying action
• Liability for judgment up to the policy limits
• Limited ability to challenge the settlement (collusion, fraud, unreasonableness, etc.)
• Forfeiture of coverage defenses (including defenses to indemnity), i.e. estoppel
Estoppel in Wisconsin?

To avoid waiver of right to contest coverage and protect itself from a finding of breach of the duty to defend, an insurer must:

1. File DJ and/or intervene in underlying lawsuit and request bifurcated trial to resolve coverage issue before liability and damages issues;

2. Enter non-waiver agreement with insured in which insurer agrees to defend and insured acknowledges right of the insurer to contest coverage; or

3. Issue ROR allowing insured to pursue its own defense not subject to insurer’s control, with fees paid by insurer.
Estoppel in Wisconsin?

Failure to follow correct procedure is a breach of the contractual duty to defend.

Insurer liable for all damages that naturally flow from the breach, including the judgment/settlement against the insured plus interest, costs and attorneys’ fees.

Damages which naturally flow from the breach can include amounts that exceed policy limits. Bad faith not required. *Newhouse by Skow v. Citizens Sec. Mut. Ins. Co.*, 501 N.W.2d 1, 6 (Wis. 1993)

Insurer also waives any subsequent right to litigate coverage.
The Indiana Supreme Court has yet to directly rule on the issue of estoppel.

One Indiana appellate decision cited the Illinois *Ehlco* decision with approval in 1999, indicating that the estoppel doctrine may be applicable in Indiana. See *Emp’rs Ins. of Wausau v. Recticel Foam Corp.*, 716 N.E.2d 1015, 1029 fn. 16 (Ind. Ct. App. 1999).

The Seventh Circuit also held that insurer which delayed six months before notifying insured of declination was estopped from relying on policy exclusion. *Federal Ins. Co. v. Stroh Brewing Co.*, 127 F.3d 563, 571 (7th Cir. 1997) (Ind.).
Estoppel in Georgia

Estoppel in Georgia is not based on an insurer’s breach of the duty to defend. See *S. Guar. Ins. Co. v. Dowse*, 605 S.E.2d 27, 29 (Ga. 2004).

Insurers are estopped from asserting coverage defenses not included in original denial letters. See *Hoover v. Maxum Indem. Co.*, 730 S.E.2d 413 (Ga. 2012).

Insurer may be estopped from asserting coverage defenses not included in denial letter even if included in pre-denial reservation of rights. See *Moon v. Cincinnati Ins. Co.*, 920 F.Supp.2d 1301, 1304 (N.D.Ga. 2013).
How To Avoid Estoppel?

- Defend under an ROR.
- Deny coverage and be right.
- Deny coverage and file a *timely* dj.
- Offer independent counsel when ROR creates conflict.
Estoppel Analysis

Step 1:

Was there a duty to defend?
1. Insuring Agreement

   a. We will pay those sums that the insured becomes legally obligated to pay as damages to which this insurance applies. *We will have the right and duty to defend the insured against any “suit” seeking those damages.*

   We may, at our discretion, investigate any occurrence and settle any claim or “suit” that may result.
The Insurer does not assume any duty to defend ... the Insurer shall advance Defense Costs of such Claim, excess of the applicable Retention amount ... .
Defense Duty Arises If Any Potential for Covered Liability In Underlying Lawsuit

Facts
    Alleged
    In Complaint
    Or Known
    To Insurer

Policy Language
Estoppel Analysis

Step 2:

Did the insurer breach its duty to defend?
Discharging Duty to Defend: Only Covered Allegations

- No breach of duty to defend if insurer provides a full defense.
- Insurer may exercise its “right” to defend by appointing counsel.
- Insurer makes all decisions regarding defense and settlement strategy.
Impact of Defending Without Reservation of Rights

In some states, insurer loses right to deny coverage.

In some states, insurer loses right to deny coverage only if insured shows prejudice.

Risky. If doubts about coverage, insurer should reserve its rights.
Discharging Duty to Defend: Covered and Uncovered Allegations

Broad duty to defend requires insurer to defend “mixed” claims, but contractual duty to indemnify only extends to covered damages.

Insurer’s objective: Avoid breaching duty to defend while preserving right to deny coverage for uncovered damages.
Option 1: Defend Under Reservation of Rights

Reservation of rights or non-waiver agreement may preserve insurer’s right to contest coverage.

Offering to defend subject to ROR may change how insurer must discharge its duty to defend to avoid estoppel.
ROR May Require Insurer To Relinquish Control of Defense

Depending on facts and controlling law, ROR may give insured the right to choose its own defense counsel.

Referred to as right to “independent counsel” (counsel who is independent of the insurance company’s control); “Cumis counsel” (CA); “Peppers counsel” (IL); or “conflict counsel.”
Four Approaches to Whether ROR Creates Right to Independent Counsel

- Insured always entitled to engage independent counsel. *(e.g. FL, MO, KY, WY).*
- Insured never entitled to engage independent counsel. *(e.g. HI, TN)*
- Insured entitled to engage independent counsel only if *potential conflict* of interest between insurer and insured.
- Insured entitled to engage independent counsel at insurer’s expense only if *actual conflict* of interest between insurer and insured.
When Does ROR Create Conflict?

Issues or facts relating to the insured’s potential liability in the underlying litigation also could affect coverage.

Concern that insurer controlling defense may provide “a less than vigorous defense” to uncovered claims or defend in a way that would place any damage award outside policy coverage.
Count I

1. The insured intentionally shot me.

Count II

2. The insured negligently shot me.
Risk of Estoppel When ROR Creates Actual or Potential Conflict

- Insurer fails to inform insured of actual or potential conflict.

- Insurer fails to inform insured that it has right to independent counsel at insurer’s expense.

- Insured requests independent counsel but insurer refuses to relinquish control of defense.

- Insurer defends but waits too long to issue ROR.
In some estoppel jurisdictions, an insurer that is unsure about whether its duty to defend has been triggered may avoid estoppel by seeking a timely declaratory judgment about its duty to defend.

An insurer cannot avoid breaching its duty to defend by filing a DJ, but it can avoid being estopped due to that breach by filing a DJ.
Estoppel Analysis

Step 3:

What rights does an estopped insurer lose?
Which Defenses Is A Breaching Insurer Estopped From Asserting?

Majority of Estoppel States

• Policy conditions (e.g. notice, cooperation, and consent to settle)
• Amount of good faith settlement
• Findings of fact in underlying action

Minority of Estoppel States

All coverage defenses
ESTOPPEL - SUMMARY

Tender/Notice

Facts Trigger Duty to Defend

Insurer Defends Under Valid Reservation of Rights
- No Estoppel

Insurer Files Timely Declaratory Judgment Action
- No Estoppel

Insurer Does Nothing
- Estoppel

Facts Don’t Trigger Duty to Defend

Insurer Does Nothing
- No Estoppel
PRACTICAL CONSIDERATIONS FOR THE INSURER AND INSURED
Questions?

The End