Lowenstein Sandler's Insurance Recovery Podcast: Don't Take No For An Answer

Episode 105:
Beyond the Defense: Exploring the Insurer's Duty to Indemnify

By Eric Jesse, Heather Weaver
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Eric Jesse: Welcome to Don't Take No for An Answer. I'm your host Eric Jesse from Lowenstein Sandler's Insurance Recovery Group. Today I'm pleased to be joined by Mike Young, who's a partner at Reichardt Noce & Young, along with my colleague Heather Weaver, who's counsel in Lowenstein's Insurance Recovery Group. Mike works on the other side of coverage cases. He represents insurers at all stages of the claims process, including litigation. Heather and Mike recently spoke on a panel together at the American Bar Association's 49th Annual TIPS Conference on a very important, but lesser discussed topic, which is the insurer's duty to indemnify.

Much of the discussion is typically focused on the insurer's broad duty to defend because that obligation will arise once there is an allegation against the insured that can potentially trigger the scope of the insurance policy and the coverage. But today, we're going to dive into a discussion on indemnity, a lesser discussed, but very important coverage obligation that both insurers and policyholders should be thinking about early on in the claim process.

With that, Mike, why don't you set the table for our loyal listeners here, and talk at a high level and explain what the insurer's duty to indemnify is and how it differs from the duty to defend?

Michael Young: Sure, happy to do that. Eric, Heather, thanks for having me on the podcast. I think it's an important topic because we spend so much time, as you indicated, Eric, trying to figure out does the insurance company have a duty to defend. Which is essentially the insurance company paying to hire a lawyer to defend the insured in a liability claim. But we

don't often think about maybe until the end, does the insurance company have a duty to indemnify, which is essentially, does the insurance company under the liability policy have an obligation to pay a judgement or settlement that might be entered against the insured?

I joked at the conference, Heather, we say all the time the duty to defend is broader than the duty to indemnify. If you haven't heard that before, you probably need to go to the Amway conference next door, I think you're in the wrong room. We say that all the time, but what does that mean? The duty to defend, in most places, is determined by looking at the allegations in the complaint and trying to see if you accept all those as true, does the claim fall within the scope of the insurance policy? Some states, maybe even a majority of them, will also allow consideration of materials outside of complaint, extrinsic evidence sometimes, to also have a duty to defend created or maybe even taken away by that extrinsic evidence.

But what about the duty to indemnify? That's the important one because that's where it comes down to is the insurance going to pay to settle this case? If so, how much? It really turns on that. When you look at cases in different states, there's not nearly as much case law on this. Sometimes, in some jurisdictions, there's literally a handful of cases and the rules can vary wildly on it. But at the end of the day, the duty to indemnify, in its simplest form, you're looking at the actual facts. We're not accepting everything in the complaint is true, but actual evidence, whatever that is. Is the lawsuit actually covered by the insurance policy? If so, the insurance company may have the duty to pay for a judgement or settlement that's entered under those actual facts.

Eric Jesse: I think you laid it out perfectly, Mike. I agree. That really is that key distinction where, the duty to defend, you're looking at the allegations that are made against the insured. Versus, all right, now there's a settlement, there's a judgement that comes up, and now the insurer and insured join issue on what is the actual evidence that does trigger coverage.

You're right, we've been looking into this issue and litigating this issue too on our various cases, and I agree with you. There's plenty of case law on the duty to defend, but when it comes to the duty to indemnify, it's certainly not as litigated as much. But it's an issue that certainly is coming up, because as policyholders, we're certainly looking for insurers to help fund or entirely fund settlements and judgements.

Michael Young: A lot of times, the claimants will plead certain things in complaints that trigger the duty to defend, which is fine. But then it comes to mediation time or trial time, "Okay, now we want you to pay for this, too." Well, not so fast. I understand what you pleaded to get us into the ballgame, but what's the reality here? Is it actually covered or not?

Eric Jesse: Yeah, absolutely. We're always trying to obviously work towards getting that contribution and making sure we can establish that, because part of this is just also having that open communication where we can just work productively together.

Heather, why don't you just give us a little bit of an overview of how an insurer's breach of its duty to defend could impact the duty to indemnify?

Heather Weaver: Sure. The breach of an insurer's duty to defend could have a huge impact on its duty to indemnify. It's important for policyholders to understand what they might be entitled to in the event their insurer breaches the duty to defend, or even worse, acts in bad faith.

As Mike mentioned, the law does vary by jurisdiction, which is one reason why it's important to consult counsel on these issues. But in at least some jurisdictions, including New Jersey, an insurer that breaches its duty to defend risks liability not only for payment of those defense costs, but also potentially for an indemnity payment for an underlying judgment or a verdict or a settlement. And also, in New Jersey and some other states, they also risk having to reimburse coverage counsel fees to the policyholder in connection with bringing a lawsuit to pursue coverage.

This type of fee shifting in a situation where the insured is forced to bring a coverage action to enforce its rights under a policy and is successful in doing so, it can be a substantial and unnecessary added expense for an insurer. Essentially, can become a situation where an insurer is essentially fighting with itself, racking up coverage counsel fees for both sides. It's obviously a valuable form of recourse for policyholders in states that have this type of fee shifting law. As a policyholder, it's important to understand whether that's something that might be available to you.

Eric Jesse: Yeah. Heather, you touched on it and Mike also touched on it, which is just the choice of law piece. Because we're speaking in generalities here, but certainly, the choice of law matters, that's certainly a theme of ours here on Don't Take No for An Answer. We certainly, as policyholders, we do like to be in jurisdictions that will give us some fee shifting leverage as we're trying to bring an underlying claim to resolution. Absolutely.

Mike, what are some things that, from your perspective, that insurers can be doing in order to avoid a coverage breach and the potential consequences of that?

Michael Young: Yeah. I think it depends on what jurisdiction you're talking about.

Eric Jesse: Yeah.

Michael Young: If you're in one like Heather was describing where, if the insurance company breaches its duty to defend, it doesn't provide defense counsel

when it was supposed to. If you're in a state that says that means estoppel, or whatever theory applies, and now you automatically have a duty to indemnify whatever happens later, boy, if you breach that duty to defend, it's catastrophic. If you're in one of those jurisdictions it's like, "Okay, guys, if we're going to decline this, we'd better be right. Because if we're not, we have a lot of bad stuff that's going to happen to us." In those places, I think insurance companies may provide defense under reservation at least in cases where maybe they wouldn't in other jurisdictions.

If you're looking at a place maybe more like where I am in Missouri, maybe Illinois, where the breach of duty to defend doesn't necessarily mean defacto you have a duty to indemnify, then you're looking at other things. It's almost as if, "Okay, we breached the duty to defend. That means we're liable for defense costs. But we still have the question, is there a duty to indemnify that judgement or settlement?" Then you're doing the same things that you might do in a state where we have to defend, otherwise there's estoppel. You're looking at, and we'll talk about this, the evidence as it proceeds in the case, what's presented to the jury, what facts are in the judgements. Do we have consent judgements? You're looking at those things, too.

I think there are some states also, and maybe Illinois is one of these, that even if you don't defend when maybe you should, if you file a declaratory judgement action, that that can somehow toll the estoppel doctrine from applying. If a court says, "Well, you did have a duty to defend," so be it. Okay, now we owe the defense costs. But we still now look at these actual facts. It's not like, "Oh, you didn't defend, now you go to jail" sort of thing. It just depends, in my view, so much on what state you're looking at.

Eric Jesse: You're absolutely right, Mike. I've just seen this issue come up recently, because you've been mentioning Illinois, where we have a client, the underlying case in Illinois. The insurer denied coverage and I get the call saying, "All right, now we think we have to sue you, file a declaratory judgement action against your client, and we don't really want to do that. Maybe we can enter into some sort of tolling arrangement along the way." Again, I think that's a little unusual in my experience, although I'm based here in New Jersey. But yeah, it could certainly run the gamut, as you described there.

Michael Young: Well, it's such a nuance on Illinois, because I'm in St. Louis, I'm in Missouri. Most of my coverage work is in Missouri, but I have at least as much coverage litigation in Illinois just because of that rule.

Eric Jesse: Yeah.

Heather Weaver: Yeah. I have a case, Mike, in New Jersey, as you mention, the procedure by which an insurance company breaches or withdraws its defense could have a huge impact. I had a case, for example, where the insurer agreed and had a duty to defend, and then instead of filing a declaratory judgement action, just pulled the defense. This was right before mediation in the underlying action. And said, "Policyholder, you're on your own. We're pulling the defense," didn't file declaratory judgement action to have their rights and obligations under the policy litigated. There were consequences for the insurer in that situation because they just didn't do it the right way and they left the policyholder in a bind.

Michael Young: Right. In New Jersey, correct me if I'm wrong, Heather, doesn't it have some nuance too on the duty to defend where maybe the carrier only has to defend covered counts versus uncovered counts? That's very, very different than my experience almost everywhere else.

Eric Jesse: Yeah. There, when we get those arguments, Mike, what we try and do is there's case law in New Jersey that we'll rely on that says when defense counsel is going to the deposition, you can't break the deposition down between the various causes of action. When defense counsel's there, they're there to defend the entire case. If their work benefits both a covered and uncovered claim, then we would certainly advocate that all of those amounts would be covered.

Michael Young: It's like when you're sitting there defending that, it's like, "Well, that's a count five question, I guess I don't have to object to that one."

Eric Jesse: Exactly. The courts are not going to require ... There's more of the practical rule here. Defense counsel shows up for that deposition, they're obviously there to defend a covered claim, so we would try and allocate those costs entirely to the insurer. Argument is and we believe the law is that the insurer would have the burden to show that a particular task was exclusively for an uncovered cause of action. If it's research regarding cause of action, the first count of the complaint and that's the one that's not covered, then all right. Then maybe there's an argument there for the insurer to allocate that cost to the insured.

Michael Young: Got it. I guess to finally answer your question, Eric, insurance companies can consider settling cases in order to prevent if there's any issues with the failure defend where we should. That's always an option as well.

Eric Jesse: Yeah, absolutely. That's also just music to our ears as coverage counsel, where we do want insurers involved in settlement. Even if they're anticipating a denial, if there's a way that we can work practically together to just bring the whole thing to resolution, that can usually benefit everyone.

Heather Weaver: Yeah, absolutely.

At the end of the day, I think the policyholder and the insurer share a common goal there, resolving claims efficiently, avoiding costly litigation for both sides, preserving resources, maintaining positive business relationships. On the policyholder side, we make sure that we openly communicate with the insurers throughout the litigation, which allows both sides to stay on the same page, make informed decisions together regarding potential settlements. It's always best when there's no surprises, and keeping everybody in the loop throughout the litigation seems to be the most effective way to do that.

Michael Young: Right, because all the stuff is expensive. Although our rates are certainly affordable and reasonable. But at the end of the day, we're paying all these different people. Defense counsel, coverage counsel.

Eric Jesse: Me.

Michael Young: We have to pay you guys if it goes wrong. Isn't settling some of these things, does it make some sense?

The other piece of it that I've seen too is maybe an insurance company gets the complaint in. Part of their defense analysis, we may just provide a defense without reservation because we think this insured has a really good liability defense. They're going to win this case eight out of nine times, whatever.

Eric Jesse: Yeah.

Michael Young: Do we really want to go and have a civil war on coverage with everyone if it's debatable? When at the end of the day, if we just defend this thing we're going to win and close the case out. There's all kinds, I think, considerations that go into that.

Eric Jesse: Yeah. The settlement piece, obviously that's where most often we see that duty to indemnify come into play. Heather, I think you touched on it, where just communication is key because a lot of times litigation's going to move at its own speed. Obviously, we want the insurers to keep pace. But if we can all just recognize, all right, there's going to be a mediation on this date. We understand that the insurers have to do their own due diligence there, they're going to have questions. Where we can get the necessary and reasonable amount of information over to the insurer, so that they can be able to participate meaningfully in a settlement opportunity, that's where I just think having those open lines of communication can be very helpful. As opposed to, "Oh, hi. There's a mediation tomorrow."

Michael Young: Yeah, that's right. From a practical perspective, because that does happen sometimes where insurance companies find out about mediations two days ahead of time, three or four days ahead of time.

Eric Jesse: Yeah.

Michael Young: Particularly when there's independent counsel defending the case. Those are really difficult for the insurance company to get its ducks in a row, to get their authority together in order to go to a mediation and really meaningfully participate. I agree, the sooner that the insurance company is notified of that stuff, then there's no excuse.

Eric Jesse: Yeah. No, in that perfect world, absolutely. This has been a great discussion. Maybe we can just bring it home with one last question here, Mike. Just from the insurer perspective here, how closely are you monitoring the factual and legal findings in the underlying case when you're just assessing that ultimate duty to indemnify obligation?

Michael Young: Hardly ever. No, I'm just kidding.

Eric Jesse: All right, the cat's out of the bag.

Michael Young: That's right. We pay no attention to that whatsoever. We're obviously looking at that all the time. Particularly when, if you're in a state, how do we determine these actual facts? If we're in a state where, if a case goes to trial and there's jury instructions with factual findings that are relevant to the coverage, boy, are we looking at that.

Then also, are we bound by those? Does collateral estoppel apply in those situations? Again, so state-dependent. But in places like, for example, my state of Missouri, we have strict rules on jury instructions. You're usually not going to get a finding by the jury or trier of fact on anything relevant to coverage. Now we're looking at the evidence that's developed during the case. What's said in these depositions? What are in those interrogatory answers? Then if cases go to trial, what kind of evidence is presented to the jury? Because even though the finder the fact may not determine anything on those facts, in a lot of states, that evidence presented may be the universe of evidence that, in a subsequent coverage case, we're going to figure out what those actual facts are, what is the evidence.

Depending on the case and the value, so forth, we may actually, coverage counsel, we're not defending the case, but we may sit in the back of the room just so we can sit here and watch all this. And see what people are saying, so we can assess, "Oh, this is more likely covered than not." Maybe that may affect those settlements as the jury is coming back. Do we take care of this before they give us their ultimate answer, because we

know what that evidence is? Then also, some places let you look and step outside of that trial evidence to figure out if there's a duty to defend. You see that in a lot in construction cases on timing issues. Sometimes the subsequent coverage case on when was the work done, or when did the damage occur, do we have a continuous trigger, all those things that we find so interesting are all based on facts. Do we have to hire experts on top of that? Now we can have trial number two to figure out if we have to pay for trial number one.

All that stuff is super important. And yet, if we're going to mediate a case, we need to know what that is before we walk in there to see what is our indemnity position.

Eric Jesse: Yeah. No, absolutely. Yeah, you described the scenario we never like to see, which is all right, we just tried the underlying case. All right, now we're going to have to go try a coverage case to figure out, to fill in gaps on those facts, which is just a proposition that policyholders just don't want to deal with. But yes, that can be the reality sometimes.

Michael Young: I think too, honestly, it's not a scenario that insurance companies want either.

Eric Jesse: Yeah.

Michael Young: Because we're doing the same thing. We're litigating with you guys, debating what happened a year-and-a-half ago at that trial.

Eric Jesse: Great. This was a great discussion. I'm sorry to have missed out on the TIPS Conference because, just from listening to you two, I know that it was a great panel discussion that you all had.

Mike, thank you so much for joining us. Heather, thank you for also coming on Don't Take No for An Answer.

Heather Weaver: Happy to be here. Thanks, Mike.

Michael Young: Absolutely. Thanks for having me.

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