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'What's in a Name[d Defendant]?': Federal Court Suggests Narrow Exception to Insurer's Broad Duty to Provide a Complete Defense

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Policyholders purchase liability insurance expecting that, when they are sued, their defense will be paid for by their insurer. Because the key value of liability insurance is that it is really "litigation insurance," courts repeatedly recognize that an insurer's duty to defend includes an obligation to pay *all* reasonable costs incurred in connection with the insured's defense. Yet, this has not deterred insurers from refusing to provide a complete defense. Insurers often insist on steep discounts when an insured is sued alongside noninsured defendants or when a covered lawsuit includes allegedly noncovered claims.

Let's take a typical example to analyze the issue. An insured business is sued, and the claimant also names that company's corporate parent as a defendant in the lawsuit. Even though the parent is a holding company that has not been accused of any specific wrongdoing, the claimant includes the parent as a defendant in hopes of accessing its assets in the event the insured subsidiary is unable to satisfy an eventual judgment. The insured subsidiary then asks its insurer to provide a defense, and the insurer offers to pay only *half* the insured's defense costs because the parent is not insured under the policy. The insurer argues that a 50-50 allocation is "fair" (it isn't) because it agreed to insure only one of the two defendants in the case.

A similar variation of this rote approach manifests when an insured is sued in a lawsuit that asserts 10 causes of action, including three that may not be covered by the insurance policy. In that instance, the insurer performs a basic "counting" exercise and agrees to pay only 70 percent of the defense costs because it contends it has no obligation to defend the remaining three causes of action. Inevitably, however, the "everything and the kitchen sink" complaint is not defended by the insured on a cause of action by cause of action basis. Rather, the gravamen of the legal dispute is often centered squarely on the covered claims such that a complete defense is required for the insurer to honor its contractual obligation under the policy.

Courts routinely have rejected insurers' mechanical approach to "mixed" claims, recognizing that a claimant's decision to sue multiple defendants has nothing to do with the insurer's contractual agreement to fully fund ***its insured's*** defense. The Ninth Circuit's opinion in *Safeway Stores Inc. v. National Union Fire Ins. Co.* represents the majority view that an insurer must pay ***100 percent*** of those costs that are "reasonably related to the defense of the insured" even if those costs "may also have been useful in defense of [an] uninsured corporation."[1] Indeed, the inclusion of a non-insured entity as a defendant does not increase the cost of the defense by ***one dollar*** where the insurer would have otherwise been required to defend the insured against the same claims. Moreover, nothing prevents an insurer from bringing a contribution action against the non-insured entity if, in fact, it unjustly benefited.

Although the law is well-settled on this issue, the United States District Court for the District of Massachusetts recently suggested a novel and narrow exception to the general rule that an insurer must provide a complete defense for mixed claims. *Lionbridge Technologies Inc. v. Valley Forge Ins. Co.*[2] addressed coverage for a lawsuit brought against an insured business and its corporate parent. The plaintiff alleged that the corporate parent misappropriated trade secrets for the benefit of the insured subsidiary. The insurer refused to fund the entire defense because the corporate parent was not insured under the policy. The court held that the insurer "must pay all of the reasonable costs of [the insured]'s defense, even if they involve a non-insured defendant who also received a benefit," but then left open the question of whether it was "reasonable" – "in light of the surrounding circumstances" – for the insurer to fund the entire defense.

Insurers will try to cite *Lionbridge* for the broad proposition that defense costs must always be allocated when a lawsuit involves covered and noncovered components. However, the precedential and persuasive value of this opinion is limited for several reasons.

<u>**First**</u>, the *Lionbridge* opinion did not alter – and, in fact, expressly reinforced – the rule that an insurer must fully fund its insured's defense even if the lawsuit includes noncovered claims and/or noncovered defendants. The court did ***not*** hold that it is appropriate to allocate defense

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[1] 64 F.3d 1282, 1289 (9th Cir. 1995).
[2] 2023 WL 5985288 (D. Mass. Sept. 14, 2023).

costs whenever a lawsuit involves multiple defendants. The court also did not address the related, but distinct, situation where a lawsuit against an insured includes both covered and noncovered claims. Rather, the decision considered only the narrow question of whether it is "reasonable" for an insurer to fund the entire defense of both an insured and its uninsured corporate parent under the particular circumstances of the case.

Second, the circumstances in *Lionbridge* are both narrow and unique. The conduct of the non-insured parent – and not the insured subsidiary – was at the center of the underlying action. The parent was accused of entering into a bidding process to purchase the plaintiff company as a pretext for accessing trade secrets. The parent allegedly intended to use that information to give the insured subsidiary a competitive advantage over the plaintiff. Under these circumstances, the court found that it would not be "fair" to impose the entire cost of the defense on the subsidiary's insurer.

Third, the *Lionbridge* opinion ultimately rests on unstable ground. Relying on two unpublished trial court opinions, *Lionbridge* grounded its decision to override the parties' contractual agreement on general principles of fairness. However, insurers that do not wish to provide a complete defense know how to draft policy language that expressly addresses the handling of "mixed" claims. Here, the insurer included no allocation language in its policy to override the majority and common law rule requiring a complete defense. Nevertheless, *Lionbridge* suggested that the concept of allocation may be injected into a policy without express language; as a result, this case will remain an outlier when viewed in the context of the weight of authority.

Finally, the "fair" result that Lionbridge sought to effectuate is illogical. It will, in practice, result in wasteful and duplicative efforts by policyholders to avoid an "allocation" discount. When forced to accept any meaningful discount on its reasonable attorneys' fees because an uninsured affiliate is also named in the lawsuit, the uninsured party may hire a separate affordable law firm to coordinate the defense with the insured's counsel. With separate representation in place for both companies, the policyholder would once again be restored to its right to coverage for 100 percent of attorneys' fees from the insurer. But at a macro level, *Lionbridge* leads to increased costs of party and insurer resources as well as judicial inefficiencies caused by involving in the defense another set of lawyers, who will unavoidably duplicate efforts. Thus, in most cases, the *Lionbridge* exception would result in no less responsibility for insurers while adding unnecessary burdens on courts and policyholders when compared with the sensible and established majority approach.

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