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Deftly navigating insurance-coverage disputes

A MESSAGE FROM THE TORTURED INSURANCE LAWYERS DEPARTMENT

In the realm of personal-injury and property-damage lawsuits, liability insurance coverage significantly influences case outcome. At its core, liability insurance covers legal costs and payouts for which the insured party is deemed liable. However, when insurance companies refuse to defend or pay, understanding the nuances of insurance coverage and bad-faith liability becomes critical. Misinformation or ignorance about coverage issues that limit or preclude recovery when litigating an injury case can lead to catastrophic blues and feel like death by a thousand cuts. Maneuvering through the treacherous terrain of coverage disputes and bad-faith insurance litigation requires an understanding of insurance concepts and terminology, as well as the ability to anticipate the moves and chain reaction of countermoves between claimants and insurers.

The importance of liability insurance in society extends beyond the insured; it also promises potential compensation to those harmed by the insured's actions that would otherwise be unavailable where the defendant is insolvent or lacks assets. However, this essential tool often positions consumer attorneys as both the archer and the prey – a blessing in providing a pathway to compensation for clients, yet a curse in the complexity and obstacles it introduces: the dual challenge of not only proving liability and damages but also ensuring these claims are encompassed by insurance coverage.

Insurers frequently resist paying claims by invoking various exclusions or interpreting policy terms in a way that narrows or eliminates their obligations. Coverage issues complicate the litigation process, potentially depriving injured parties of rightful compensation. It is essential to correctly ascertain applicable coverages and understand exclusions and conditions that may affect recovery of damages.

A labyrinth of applicable policies and coverages

The most basic type of liability insurance is commercial general liability, which covers a business against claims of property damage, bodily injury, certain personal torts, and false advertising. Specialized insurance policies, such as cyber insurance or environmental liability, were born out of the most common exclusions in a CGL policy. It is important at the outset of your case to know the types of liability insurance that may cover the conduct complained of.

For instance, in a construction-defect claim, you want to know if the defendant has product and completed-operations coverage, which covers liability for property damage or personal injury caused by defects in construction work or manufactured products.

In the realm of toxic torts, look to environmental-impairment liability (EIL) insurance to provide coverage. EIL insurance is designed to cover claims arising from the release of pollutants into the environment, including soil, water, and air contamination which are excluded by CGL policies.

Avoiding bad blood with defense counsel

Attorneys often receive incorrect information regarding coverage disputes or policy limits from defense counsel. When pressed for specifics about coverage, the typical response is "I'm not coverage counsel." This seemingly flies in the face of the attorney's duties of competency and loyalty to their client, i.e., the insured. However, because of the tripartite relationship created when a liability insurer hires counsel to defend its insured, defense counsel owes duties to both the insured and the insurer. (*Purdy v. Pacific Automobile Ins. Co.* (1984) 157 Cal.App.3d 59, 76.) Nonetheless, defense counsel must still follow the Rules of Professional Conduct. (*Gafcon Inc. v. Ponsor & Assoc.* (2002) 98 Cal.App.4th 1388, 1411-1412.) Even when defense counsel is willing to share information about coverage issues, they may be misinformed because they are simply repeating what an adjuster told them. Thus, it is essential that you independently verify information regarding available insurance and coverage issues.

Form Interrogatory 4.1 requires parties to identify certain information about available insurance, including the existence of a coverage dispute. Do not assume the information is complete and accurate. Although the response is verified under oath by the responding party, the response was likely drafted by the same defense attorney who told you they do not get involved in coverage and is rarely, if ever, verified by the insurer.

Fortunately, the recent amendment to Code of Civil Procedure section 2016.090 offers a lifeline. Section 2016.090, subdivision (a)(1)(C) requires parties to provide an initial disclosure that includes, among other things, any liability policies that may be used to satisfy a judgment in the action. Additionally, section 2016.090, subdivision (a)(1)(D) requires production of indemnity agreements and reservation of rights ("ROR") letters.

This is critical because insurers have long maintained that ROR letters are privileged. Certain communications between a liability insurer defending its insured are privileged. (*Heffron v. Los Angeles Transit Lines* (1959) 170 Cal.App.2d 709, 718.) However, the initial ROR letter is usually based on the allegations in the operative complaint and applicable policy language, neither of which was part of a privileged communication between the insurer and insured. The requirement of section 2016.090 to produce ROR letters seemingly conflicts with section 2017.210, which restricts discovery regarding the nature or substance of a coverage dispute. It will be a few years before the conflict is resolved by an appellate court. In the meantime, if you encounter a blanket refusal to

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produce ROR letters based on privilege, offer to accept a redacted version that omits any statements to or by the insured regarding the substance of the lawsuit.

Deciphering policy documents so you can read them like a magazine

After obtaining the insurance policy and ROR letters, attorneys often feel happy, free, confused, and lonely at the same time. You can survive the great war of insurance coverage disputes by knowing the fundamentals about insurance policy documents.

When analyzing coverage under liability policies, it is important to understand the difference between an insurer's duty to defend its insured and to indemnify. The duty to defend obligates the insurer to provide its insured with competent defense counsel to handle defense of the underlying action and pay for fees and costs incurred in providing a defense. The duty arises upon proper notice to the insurer of a claim made against the insured, which is potentially covered under the policy, and is initially analyzed by comparing the allegations in the complaint to the applicable policy language. (*Gray v. Zurich Ins. Co.* (1966) 65 Cal.2d 263, 275-276.)

The duty to indemnify obligates the insurer to pay money to compensate an injured third party, i.e., the plaintiff. This obligation does not arise until an insured becomes legally obligated to pay money to an injured party, usually via a judgment or settlement. The duty to indemnify is limited to claims and damages that are actually covered under the policy, and is determined based on the acts or omissions of the insured upon which liability was imposed, e.g., accidental or intentional conduct. (*Buss v. Superior Court* (1997) 16 Cal.4th 35, 45-46; *American State Ins. Co. v. Travelers Property Casualty Co. of America* (2014) 223 Cal.App.4th 495, 506.)

Four components to the insurance policy

There are four components to every insurance policy: Declarations; Insuring agreement; Conditions; and Exclusions. These appear in three main sets of documents which comprise "the policy." They are (1) the Declarations; (2) Form Policy or Policy Booklet; and (3) Endorsements. Knowing what each set of documents contains will help ensure that you truly have a full and complete copy of the policy.

Declarations

The Declarations, commonly referred to as the "dec page," is arguably the most important part of the policy and is the document you want to read first. It provides a summary of the important points of the insurance coverage including the name of the insured(s), a description of the property or type of risk being covered, the type of coverages provided and corresponding limits, the effective policy dates, and the list of applicable endorsements. The number of endorsements for liability policies is usually so long they are listed on a separate page. It is important to review the list of endorsements to confirm that you have them all and that you have the correct version.

Policy Form

The Policy Form includes the standard provisions of the insuring clauses, coverage exclusions, and conditions. Because insuring and exclusion clauses usually read like nightmare discovery requests – every other word is specially defined – it is important to review the "Definitions" section and identify all important terms. Defined terms in the body of the policy can usually be identified because they appear in bold text or are capitalized.

The insuring agreement or clauses explain the risks that are insured under the policy. CGL policies usually identify these provisions under risk-specific headings, e.g., "Coverage A – Bodily Injury and Property Damage," and "Coverage B – Personal and Advertising Injury." Note that just because a coverage provision is included in the policy form does not mean it applies – you need to check the Declarations to confirm that the insured purchased such coverage. Also, some coverages (called "additional coverages" because they must be specifically purchased and require an additional premium), appear in the policy as an endorsement.

Conditions dictate the obligations of both the insurer and the insured. This section includes requirements such as prompt notification of claims, cooperation during the investigation, and procedures for filing a claim. It is vital that the defendant-insured comply with all policy conditions, including the duty to cooperate in the defense; otherwise, they may forfeit coverage.

There are three major types of exclusions: excluded perils, excluded losses, and excluded property. As the name makes obvious, exclusions identify what is not covered by the policy, even if the claim falls within the scope of insuring clauses. Exclusions can limit coverage for certain types of risks, locations, or activities, or they can eliminate coverage all together, e.g., an absolute exclusion. Be mindful of exceptions to exclusions which usually follow an absolute exclusion. These provisions give back a limited form of the coverage taken away by the absolute exclusion. Exclusions are found in both the form policy and the endorsements, underscoring the importance of reviewing and analyzing the policy as a whole.

Endorsements

Endorsements modify the original policy terms, either expanding or limiting coverage. Review all endorsements to understand how they alter the policy's scope. Some endorsements might specifically add or exclude coverage for certain types of claims. They can include any of the above provisions: the insuring clause, conditions, or exclusions. Pay particular attention to the introductory language of the endorsement to determine if the endorsement provision replaces an existing provision of the form policy or adds to it, or operates as a stand-alone policy, which is often the case when additional or special coverages are included.

Applying the facts of your case to the insurance policy is a crucial step in

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determining whether the insurer has a duty to defend or indemnify the insured. You first want to look at the insuring clause and determine whether the defendant's conduct or your client's injuries fall within the scope of this provision. Next, look at the exclusions, including any in the Endorsements, to determine if they preclude or limit coverage. If any policy provision is unclear, review case law to understand how courts interpret that provision. This can be done by searching for cases that include the same policy language. Be mindful, however, that not all policies are the same and use caution when relying on older decisions. A case with a favorable interpretation may not apply if the policy language varies. Additionally, insurers will often modify policy language following unfavorable appellate decisions. Thus, it is important to analyze coverage on a case-by-case basis. For complex coverage issues, consider consulting with coverage counsel.

Is it over now?

You reviewed the policy documents and determined your client's claims are at least potentially covered. The end should be in sight, but you are not out of the woods yet. Assuming the carrier has unreasonably rejected a valid policy limits demand, your next move will depend on whether the carrier is providing a defense. If the carrier is defending, it is important that the insured-defendant continue to cooperate with defense counsel and allow the carrier to control the defense and any settlement of the claim; otherwise, insured-defendant may violate policy conditions. (*Hamilton v. Maryland Casualty Co.* (2002) 27 Cal.4th 718, 726 [Insured cannot settle or enter into stipulated judgment, and must still mount a defense].)

Thus, when the carrier is defending, the only recourse following unreasonable rejection of a settlement offer is to proceed to trial, obtain a judgment, then sue the carrier, either pursuant to an assignment of rights, or Insurance Code section 11580, subd. (b)(2). If your client is still willing to accept policy limits to avoid trial, you should renew the demand at least once and really drive home the likelihood of an excess judgment. Threats of bad-faith liability ring hollow for liability adjusters unless there are compelling facts, so be sure to identify specific evidence that clearly establishes the defendant's liability or the amount of damages being claimed, or why the defense experts' opinions are unreasonable.

Consider engaging the insurer through defense counsel. Settlement demands, whether in the form of a demand letter or Offer to Compromise pursuant to Code of Civil Procedure section 998, must be communicated to the client, which includes both the insured and the insurance company. While defense counsel will always be "defense counsel," e.g., trying to minimize damages or attack damages by arguing pre-existing injury or delay in treatment, they must still make efforts to avoid exposing their clients to liability. Indeed, courts recognize that the attorney's primary obligation is "to further the best interests of the insured." (*Purdy v. Pacific Automobile Ins. Co.*, *supra*, 157 Cal.App.3d at p. 76.)

Engage defense counsel as an advocate

Ensure that the defense counsel fully understands the gravity of the situation and the potential financial and reputational risks to the insured if the insurer refuses to settle. Have the defense counsel communicate to the insurer, in no uncertain terms, the legal obligations under California law to act in good faith and the peril of a bad-faith lawsuit if they fail to protect the insured's interests.

Setting this out in the letter with a copy sent to the adjuster is the best way to ensure this information is communicated directly to the adjuster. Company defense guidelines will require defense counsel to present a thorough analysis of the demand and the probable outcomes if the case goes to trial. However, if you include this analysis in your letter, defense counsel can piggyback on your argument, which also ensures it is properly communicated to the carrier. By effectively engaging defense counsel as an advocate, you can apply significant pressure on the insurer to accept a reasonable settlement offer.

When insurer refuses to defend

If the insurer has refused a defense, the insured defendant has more freedom and available options to avoid protracted litigation. The insurer has no right to control the defense or settlement of the underlying case, and the insured's obligations, e.g., to cooperate in the defense, are suspended. Additionally, the insured is no longer required to notify the insurer about important dates or events, e.g., service of summons or the trial date. (*Samson v. Transamerica Ins. Co.* (1981) 30 Cal.3d 220, 238-239.) Thus, it is prudent at this juncture to reach an agreement with the insured defendant to resolve the case without a jury trial and assign all rights and claims against the insurance company.

Understand the assignment

An assignment of rights and claims is essential for recovering an excess judgment. Simply put, this legal mechanism allows an insured to transfer some of their rights to pursue claims and recoveries under an insurance policy to the plaintiff. Without an assignment, the only direct claim that can be made is as a third-party beneficiary and recovery is limited to the policy limits. (Ins. Code, § 11580; *Catholic Mutual Relief Society v. Superior Court* (2007) 42 Cal.4th 358, 367, [Section 11580 "effectively makes an injured plaintiff who obtains a final judgment against a tort defendant a third-party beneficiary of the defendant's liability insurance policy"].) Thus, an assignment of rights is an absolute condition precedent to suing an insurer for bad-faith failure to settle and recovering on an excess judgment. (*Murphy v. Allstate* (1976) 17 Cal.3d 937; *Hand v. Farmers* (1994) 23 Cal.App.4th 1847.)

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To ensure that an assignment of rights and claims is enforceable and paves the way for recovery against the insurance company, the agreement must include essential terms and conditions. The assignment must state the specific rights and claims being transferred. Certain claims, such as emotional distress and punitive damages, are considered personal claims and are therefore not assignable. (*Murphy v. Allstate*, *supra*, 17 Cal.3d at p. 942.) To recover these damages, the insured defendant must be named as a co-plaintiff in the bad-faith lawsuit. A provision requiring the insured defendant's cooperation in the bad-faith lawsuit is essential.

Getting the judgment without a glitch

To pursue the insurer company directly pursuant to a bad-faith assignment, you must first obtain an enforceable judgment. There are four options for resolving the underlying action: stipulated judgment, default prove-up hearing, uncontested trial, or judicial reference under Code of Civil Procedure section 638.

A stipulated judgment is the most efficient and least costly of the options; however, it is most likely subject to collateral attack by the insurer claiming collusion or fraud because it was not the result of an adjudication of the merits.

An uncontested trial can be costly and time-consuming, but it is less likely to be undermined. It operates in the same manner as any other trial except the defendant does not take any steps to defend – there is no cross-examination of the plaintiff's witnesses and no evidence offered in the defendant's case-in-chief.

A default prove-up hearing is similar to an uncontested trial but less costly and liability and damages are decided entirely by the trial court. However, the insurer has the right to intervene and set aside the default judgment.

A judicial reference under Code of Civil Procedure section 638 is similar to a private arbitration. The agreed-upon referee, usually a retired judicial officer, will decide all issues, including findings of fact, liability, and damages. A written statement of decision is issued, similar to a bench trial. That decision can then be entered as a judgment.

Be sure the judgment includes not just damages, but also any costs, interests, and attorneys' fees your client would otherwise be entitled to. Some policies exclude attorneys' fees from indemnity coverage, so best practice is to itemize the damages and make it easy for the carrier to identify the covered damages in the judgment.

Starting to see daylight

What to do next depends in large part on the amount of your judgment. If you have a judgment within policy limits, you should make a written demand to the carrier for payment of the full judgment. Liability for bad-faith failure to settle before entry of judgment requires an excess judgment and the plaintiff must have an assignment to recover the full amount. But where the insurer unreasonably rejects a post-judgment demand, the plaintiff can sue the insurer directly for breach of contract and bad faith as a third-party beneficiary under Insurance Code section 11580 based on the unreasonable refusal to pay the judgment. (*Hand v. Farmers*, *supra*, 23 Cal.App.4th at 1860-1861.) Additionally, upon accrual of the bad-faith claim, the plaintiff can recover attorneys' fees going forward under *Brandt v. Superior Court* (1985) 37 Cal.3d 813. Thus, it is important to keep track of time spent on enforcing the judgment.

If you have a judgment in excess of the policy limits, your next step is to file the bad-faith action pursuant to the assignment. You cannot recover the full amount of an excess judgment without a bad-faith assignment. Best practice is to get the assignment before judgment is entered. If the underlying judgment was obtained following an adjudicative proceeding, it is presumptive proof of the value of the claim.

This is important because an excess judgment can only be recovered where there is a bad-faith failure to settle, i.e., insurer unreasonably refused to settle the claim within policy limits. (*Crisci v. Security Ins. Co. of New Haven* (1967) 66 Cal.2d 425, 460.) Additionally, the insurer cannot relitigate its insured's liability or the damages awarded. Thus, the bad-faith litigation focuses on the reasonableness of the insurer's investigation and claim denial.

End game

One common theme is apparent from the vast body of law discussing the failure to defend and indemnify: The analysis and result depend on the particular facts of the case and policies in play. Continuously evaluate coverage and bad-faith liability throughout your case so you never miss a beat and stay lightning on your feet.

Insurers will always roll loaded dice. But, armed with a solid command of insurance terminology and coverage, you will teach them that when they play stupid games, they win stupid prizes.