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Client Update

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In this Edition

- Teleseminar - *To Defend or Not to Defend? Weighing the Potential Consequences of Not Defending Your Insured*
- Florida Appellate Court rules that an appraisal awards satisfies the condition precedent to a bad faith action
- Horizontal exhaustion and triple trigger for asbestos injury, and the insured's ability to renegotiate policy limits retroactively
- Broad Scope of Colorado's unreasonable Delay/Denial statute
- Florida Supreme Court restricts Economic Loss Rule
- Proper application of Oregon's duty to defend rules in summary judgment context
- The Duty to Defend: Hiring defense counsel isn't enough

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Teleseminar - To Defend or Not to Defend? Weighing the Potential Consequences of Not Defending Your Insured

On February 19th, ALFA International hosted a teleseminar entitled To Defend or Not to Defend? Weighing the Potential Consequences of Not Defending Your Insured. Three ALFA attorneys offered their experience and insights to an online audience of several dozen clients. Nicole M. Nowlin with Cosgrave Vergeer Kester, LLP in Portland, OR moderated the discussion. She was joined by Joshua Zimring with Lester, Schwab, Katz & Dwyer, LLP in New York, NY and Lisa F. Mickley with Hall & Evans, LLC in Denver, CO.

The panel addressed a myriad of issues facing carriers when a claim seeking defense is tendered, exploring the different standards and duties imposed in venues across the country. It also discussed claims available to plaintiffs in coverage actions; for instance, some states allow extracontractual recovery for both common law bad faith and statutory claims, and others allow only contract claims.

Ms. Nowlin offered insights into potential waiver and estoppel concerns carriers may encounter, including the failure to timely reserve rights upon receipt of a claim, or when learning new information. Her discussion highlighted some statutorily imposed deadlines and various court rulings across the country interpreting the timeliness requirement; as part of this discussion, Mr. Zimring offered his insights about New York's statute requiring carriers to disclaim or deny coverage "as soon as is reasonably possible."

Mr. Zimring followed with an in depth exploration of reservation of rights correspondence and the duty to defend. His discussion noted the differences between jurisdictions requiring that carriers' evaluation of trigger include extrinsic facts, and those limiting the analysis to the four corners of the complaint itself. The majority follow the rule that, once triggered, carriers owe their insureds defense on all claims, including those potentially covered and those that are not. Mr. Zimring also discussed the importance of expressly reserving the right to seek reimbursement in the event of a later determination that no coverage was owed, and the measure of reasonable defense costs.

Finally, Ms. Mickley focused the audience's attention on the exposure faced by carriers when sued. Her presentation explored the various types of damages available to coverage plaintiffs, including measures of contract damages, differing measures of extracontractual recovery, both bad faith and statutory damages, and which states allow fee shifting as part of such potential recovery. Her discussion also included some practical considerations when defense is denied, such as the inability to contest defense counsel fees and rates when denying the duty to defend, and when and whether carriers may be bound by settlements entered by the insured.

Mr. Zimring and Ms. Mickley will continue an exploration of these issues in a breakout session at the upcoming ALFA International Insurance Roundtable this June in New York. This session will build on some of the concepts discussed in the teleseminar, with an interactive discussion of practical implications, and when carriers may want to exercise the right to defend. The teleseminar is available on the ALFA International website as a podcast.

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Florida Appellate Court rules than an appraisal awards satisfies the condition precedent to a bad faith action

On April 13, 2013, an Opinion in *Hunt v. State Farm Florida Insurance Co.*, 38 Fla. L. Weekly D774, a Florida district appellate court held that a payment of an appraisal award satisfied the condition precedent for a bad faith action. Hunt's home sustained sinkhole damage. He disagreed with the damage estimate provided by State Farm, filed a civil remedy notice pursuant to Florida Statute §624.155 and commenced an action for breach of contact. State Farm successfully enforced the appraisal provision of its property damage policy. An appraisal was performed and State Farm paid the same as well as Hunt's attorneys' fees and the first action was dismissed. Hunt then filed a new action seeking bad faith damages. State Farm moved for summary judgment arguing that the appraisal did not constitute a resolution of the underlying lawsuit

favorable to the insured as required as a condition precedent to a bad faith action. State Farm further contended that the civil remedy notice was inadequate as it did not state a cure amount certain. The lower court granted summary judgment to State Farm expressly acknowledging both arguments. The ruling was based in part on the Florida Supreme Court decision in *Blanchard v. State Farm Mutual Automobile Insurance Co.* 575 So. 2d 1289 which held that a bad faith action cannot accrue until the underlying suit is resolved in the insured's favor. Hunt appealed and the summary judgment was reversed. Stating that "a judgment on a breach of contract action is not the only way of obtaining a favorable resolution," the court held that an appraisal establishing the validity of an insured's claim satisfies the condition precedent as a "resolution in favor of the insured." Citing *Trafalgar at Green Acres, Ltd. v. Zurich American Insurance Company*, 100 So.3d 1155. The court further held that the civil remedy notice was not defective. Florida Statutes do not expressly require that the CRN allege a specific cure amount. The case is silent as to whether the condition precedent to a bad faith action is met if the appraisal amount does not exceed previous offers of the insurer.

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Another look at horizontal exhaustion and triple trigger for asbestos injury, and the insured's ability to renegotiate policy limits retroactively

Toxic tort cases present courts with numerous opportunities to revisit coverage law, and few toxins have provided as many opportunities for reflection on insurance principles as asbestos. Thus, it was little surprise that the Illinois Court of Appeals was again called upon to reconsider questions of horizontal exhaustion and trigger of coverage for asbestos cases in *John Crane, Inc. v. Admiral Insurance Co.*, 2013 IL App (1st) 093240-B, 2013 Ill. App. LEXIS 109 (1st Dist. March 5, 2013).

Initially, *Crane* presented the issue of the extent to which an insured and its primary carrier can agree, retroactively, to modify the limits of the primary coverage at the expense of excess carriers. The insured, John Crane, Inc. ("Crane"), had primary coverage with Kemper for policy periods between 1944 and 2001. Crane, a defendant in more than 250,000 asbestos-related bodily injury suits, had negotiated with Kemper to adopt a no settlement policy in asbestos lawsuits, based on Crane's firmly held belief that it was not liable. However, when Kemper experienced financial difficulties, Kemper and Crane entered into an agreement under which the policy limits were revised from cost exclusive to cost inclusive, in exchange for a small increase in the overall limits of coverage. The agreement only modified the limits of policies incepting after 1986, during which time Crane did not have excess insurance.

Crane's excess insurers challenged this agreement, arguing that before the excess policies could be triggered, all of the Kemper primary policies had to be exhausted at their original limits. Crane disputed this, arguing that the excess carriers had no standing to challenge the agreement since all of their policies predated the policies affected by the agreement. The Illinois Appellate Court strongly rejected Crane's argument. The court noted that Illinois required exhaustion of all triggered primary coverage, including uninsured and self-insured periods, before any excess policies would be triggered. An insured may not enter into an agreement with a primary carrier to change the primary carrier's limits, except by agreeing to cover those periods itself. Moreover, nothing in the horizontal exhaustion doctrine changes simply because the primary coverage post-dates the excess coverage. Whether the primary coverage is earlier than the excess coverage, covers the same policy period, or post-dates the excess coverage, it must be exhausted pursuant to its original terms before any of the excess coverage will be triggered.

The court next turned to the question of how the losses should be allocated among the excess carriers for various policy years. Under Illinois law, all carriers on the same coverage layer are jointly and severally liable for all losses with occurrence dates during their

policy periods. *Zurich Ins. Co. v. Raymark Industries, Inc.*, 118 Ill. 2d 23, 57, 514 N.E.2d 150 (1987). The Illinois Supreme Court in Zurich rejected the argument that insurers should allocate losses on a pro-rata basis based on time on the risk.

In *Crane*, the insurers again sought a pro-rata allocation in determining the amount of each carrier's liability, while Crane argued that the insurers were jointly and severally liable for all judgments arising during their policy periods, up to their policy limits. The insurers argued that Illinois law had evolved to allow a time on the risk allocation, citing to appellate court decisions involving coverage for environmental damage. The court disagreed, noting that the cases the insurers cited, *Outboard Marine Corp. v. Liberty Mutual Ins. Co.*, 283 Ill.App. 3d 630 (1996) and *Federal Ins. Co. v. Binney & Smith*, 393 Ill.App. 3d 277 (2009), both involved coverage for property damage rather than bodily injury, and bodily injury and property damage are two distinct concepts that require different characterizations of their coverage triggers. Thus, it reaffirmed that under Illinois law, all policies on the risk when the underlying plaintiffs' bodily injury or sickness or disease occurs are jointly and severally liable up to their policy limits.

With respect to bodily injury, the court applied the triple trigger theory, based on the fact that the policies define "bodily injury" as "bodily injury, sickness or disease." The court found that bodily injury occurs at the time of exposure to asbestos. Disease begins as of the date of diagnosis or death, and sickness is defined as ill-health, or when a person suffers from a weakened or unsound condition. The court rejected a continuous trigger theory, finding that there was no evidence that bodily injury continued after the plaintiff was no longer being exposed to asbestos but before either sickness or disease became manifest. Thus, the insured must prove one or more of the trigger dates, and is entitled to coverage under all policies in existence when any of the triggers occur.

The decision in *Crane* reaffirms Illinois' strong adherence to the horizontal exhaustion doctrine. Likewise, it rejected the argument for pro-rata allocation of asbestos damages based on time on the risk, continuing to favor the triple trigger theory.

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Broad scope of Colorado's unreasonable Delay/ Denial statute

Colorado courts broadly interpret the statutes affording recovery for unreasonably denied or delayed payments, increasing potential for extracontractual exposure to carriers. Colorado statute C.R.S. § 10-3-1115 provides that insurers "shall not unreasonably delay or deny payment . . . for benefits owed to or on behalf of any first party claimant." C.R.S. § 10-3-1116 creates a private right of action by first-party claimants for unreasonable denial or delay of payments by carriers. The statute allows for recovery of "two times the benefit owed," plus recovery of attorney fees and costs.

Though the use of the term "first party claimant" suggests this statute is limited to first party policies and benefits, several trial courts have broadly construed the statutory definition of this term to also include liability policies. Courts have ruled that this statutory claim is separate and distinct from a claim for common law bad faith. *Kisselman v. Am.Family Mut. Ins. Co.*, -- P.3d -- (Colo.App. 2011).

In *Kyle W. Larson Enters. v. Allstate Ins. Co.*, 2012 COA 160M, -- P.3d -- (Nov. 8, 2012), the Court of Appeals interpreted the definition broadly to include a non-insured claimant, a vendor. In Larson, a roofing contractor hired by homeowner-insureds, who was to be paid from insurance proceeds and who had authority to communicate directly with the carrier, was a "first-party claimant" as defined by the statute because the contractor was asserting a claim "on behalf of" the insureds. The Court held that the contractor had standing to assert a direct claim seeking statutory relief. Combined with earlier rulings holding this statute applicable to liability policies, this statutory claim poses considerable exposure for carriers, and incentives for both plaintiffs and the plaintiffs' bar to file coverage actions.

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Florida Supreme Court restricts Economic Loss Rule and provides crown to plaintiffs seeking unlimited additional tort damages

The economic loss doctrine typically prevents plaintiffs from pursuing tort claims over financial losses stemming from contracts. However, in *Tiara Condominium Association, Inc. v. Marsh & McLennan Companies, Inc.*, 2013 WL 828003 (Fla. March 7, 2013), the Florida Supreme Court held that the economic loss rule is now limited to products liability cases. Tiara Condominium Association, Inc. ("Tiara") claimed that Marsh & McLennan Companies, Inc.'s ("Marsh") mistakes caused it to spend more than $100 million to repair damage from hurricanes Frances and Jeanne. Tiara's insurer took the position that its policies only offered $50 million in coverage.

Factual Background

Tiara retained Marsh as its insurance broker. One of Marsh's responsibilities was to secure condominium insurance coverage. Marsh secured windstorm coverage through Citizens Property Insurance Corp. ("Citizens"), which issued a policy that contained a loss limit in an amount close to $50 million. In September of 2004, the condominiums managed by Tiara sustained significant damage caused by Hurricane Frances and Jeanne. Tiara began to remediate the condominiums.

Marsh assured Tiara that the loss limits of coverage was per occurrence rather than coverage in the aggregate. As two hurricanes caused damage to the condominiums, Tiara believed that it would be entitled to approximately $100 million. Tiara began with more expensive remediation efforts and expended more than $100 million on same. Tiara then sought payment from Citizens. Citizens claimed the loss limit of $50 million was in the aggregate, not per occurrence. Tiara and Citizens settled for approximately $89 million.

In October of 2007, Tiara filed suit in federal court against Marsh, alleging, *inter alia:* negligence and breach of fiduciary duty for failing to advise Tiara of its complete insurance needs and failing to advise Tiara of its belief Tiara was underinsured. The trial court granted summary judgment in favor of Marsh on, *inter alia*, the aforementioned counts and Tiara appealed to the Eleventh Circuit. The Eleventh Circuit then certified a question to the Florida Supreme Court on whether an insurance broker can defeat tort claims brought by policyholders who have suffered only economic damages through their relationships with the insurance brokers.

Analysis

The Economic Loss Rule Defined

The Court began with an analysis of the origin and development of the economic loss rule. The Court noted the Rule was created to address the issues brought on by attempts to apply tort remedies to traditional contract law damages. The Court noted its decision of *Casa Clara Condominium Ass'n, Inc. v. Charley Toppino and Sons, Inc.*, 620 So. 2d 1244 (Fla. 1993), wherein it stated that "the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby encourages citizens to avoid causing physical harm to others." *See Tiara*, 2013 WL 828003 (citing *Casa Clara*, 620 So. 2d at 1246). Economic losses, the Court noted, are "disappointed economic expectations," which are protected by contract law, rather than tort law. *See Tiara*, 2013 WL 828003 (citing *Casa Clara*, 620 So. 2d at 1246). Accordingly, the Court explained, the economic loss rule is a judicially created doctrine setting forth the instances where a tort action is prohibited if only economic damages are suffered.

The Economic Loss Rule's Origins in Florida

The Court noted the economic loss rule was originally adopted in Florida in the products liability context in *Florida Power & Light Co. v. Westinghouse Elec. Corp.*, 510 So. 2d 899 (Fla. 1987), wherein the Court relied on the reasoning of *Seely v. White Motor Co.*, 403 P.2d 145, 149 (Cal. 1965) and *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 871 (1986). In *Seely*,

the California Supreme Court recognized that strict liability in tort had not supplanted causes of action for breach of express warranty. The California Supreme Court reasoned that the rules of warranty continued to function well in a commercial setting, allowing the manufacturer to determine the quality of the product and the scope of its liability if the product failed to perform.

In *East River*, the United States Supreme Court adopted the reasoning in *Seely*, noting that when the damage is to the product itself, "the injury suffered – the failure of the product to function properly – is the essence of a warranty action, through which a contracting party can seek to recoup the benefit of its bargain." *Tiara*, 2013 WL 828003 (citing *East River*, 476 U.S. at 868)(citing *Seely*, 403 P.2d at 150)). In *East River*, the U.S. Supreme Court reasoned that contract law – the law of warranty in particular – is well suited to commercial controversies because the parties set the terms of their own agreements. *Tiara*, 2013 WL 828003 (citing *East River*, 476 U.S. at 872–73). The U.S. Supreme Court held that a manufacturer in a commercial relationship has no duty in tort, by way of negligence, strict liability or otherwise, to prevent a product from injuring itself. Thus, the focus of the economic loss rule was directed in the products liability context for damages arising from defects in the product itself.

Expansion of the Economic Loss Rule

The Court in *Tiara* noted that while the economic loss rule's underpinnings were in the products liability context, the Rule has been extended to circumstances beyond products liability claims when parties are in contractual privity and one party attempts to recover damages in tort for matters arising from the contract. The Court noted that the rationale for extension of the economic loss rule to cases where parties are in contractual privity was that contract principles were more appropriate for addressing remedies for consequential damages that the parties could have, or should have, provided for in their contractual agreement.

The Court then noted the various exceptions to the application of the economic loss rule in cases where parties are in contractual privity with one another, such as when a tort has been committed independently of the breach of contract, for instance fraud in the inducement and/or negligent misrepresentation. Further, the Court noted the exception to application of the economic loss rule in cases of contractual privity when there has been neglect in providing professional services.

In addition, the Court noted in I*ndem. Ins. Co. v. N. Am. v. American Aviation, Inc.*, 891 So. 2d 532, 536 (Fla. 2004), which reaffirmed its decision in Florida Power, that it recognized the Court's history of unprincipled extension of the economic loss rule, and concluded that the Rule should be expressly limited to the original rationale and intent of *Seely*, *East River*, and *Florida Power*. Despite this recognition, the Court noted that the *American Aviation* decision left the expansion of the economic loss rule intact.

Holding

The Court provided that while it has expressed an intent to return to the origins and purpose of the economic loss rule, it has not taken action commensurate to such an intent. As such, the Court held that it "recede[s] from [its] prior rulings to the extent that they have applied the economic loss rule to cases other than products liability." *Tiara*, 2013 WL 828003. The Court briefly discussed the principle of *stare decisis*, providing that said doctrine would "yield when an established rule has proven unacceptable or unworkable in practice." *Id*. Accordingly, in Florida, the economic loss rule applies only to products liability cases. As such, the Court found it unnecessary to decide whether the exception to the Rule for professional services applies to insurance brokers.

Breach of Fiduciary Duty and Bad Faith

The Florida Supreme Court has previously held that a claim for breach of fiduciary duty against an insurer is comparable to a bad faith claim and constitutes an assignable claim. *See Wachovia Ins. Services, Inc. v. Toomey*, 994 So. 2d 980 (Fla. 2008).

Typically, defendants will assert that a breach of fiduciary duty claim is impermissibly duplicative of a bad faith claim and inextricably intertwined with the breach of contract claim. While *Tiara* limited the application of

the economic loss rule to products liability cases, it has not dispensed with longstanding Florida law that there must be a tort "distinguishable from or independent of [the] breach of contract" in order for a party to bring a valid claim in ***tort*** based on a breach in a contractual relationship. *Lewis v. Guthartz*, 428 So. 2d 222, 224 (Fla. 1982); *see also Elec. Sec. Sys. Corp. v. S. Bell Tel. & Tel. Co.*, 482 So. 2d 518, 519 (Fla. 3d DCA 1986) ("[A] breach of contract, alone, cannot constitute a cause of action in tort.... It is only when the breach of contract is attended by some additional conduct which amounts to an independent tort that such breach can constitute negligence.") Justice Pariente's concurring opinion in Tiara recognized that while the economic loss rule provided a simple way to dismiss tort claims interconnected with breach of contract claims, "it is neither a necessary nor a principled mechanism for doing so." *Tiara*, 2013 WL 828003, at *9.

Rather, these claims should be considered and dismissed as appropriate based on basic contractual principles—a proposition we reaffirmed in *American Aviation*, where we stated that "when the parties have negotiated remedies for nonperformance pursuant to a contract, one party may not seek to obtain a better bargain than it made by turning a breach of contract into a tort for economic loss." *Am. Aviation*, 891 So.2d at 542. *The majority's decision does not change this statement of law, but merely explains that it is common law principles of contract, rather than the economic loss rule, that produce this result.*

Id. (Emphasis added).

Should a court permit a breach of fiduciary duty claim to proceed, the following is a summary of requisite elements and recoverable damages that are separate and distinct from the standards that govern statutory and common law bad faith actions in Florida.

The elements of a claim for breach of fiduciary duty are: the existence of a fiduciary duty, and the breach of that duty such that it is the proximate cause of the plaintiff's damages. *Gracey v. Eaker*, 837 So. 2d 1348 (Fla. 2002). Typically, non-economic damages such as mental anguish and emotional distress damages are limited by the "impact rule," which requires that a plaintiff seeking to recover emotional distress damages in a negligence action prove that "the emotional distress ... flow[s] from physical injuries the plaintiff sustained in an impact [upon his person]." *R.J. v. Humana of Florida, Inc.*, 652 So. 2d 360, 362 (Fla. 1995). Florida's version of the impact rule has more aptly been described as having a "hybrid" nature, requiring either impact upon one's person or, in certain situations, at a minimum the manifestation of emotional distress in the form of a discernible physical injury or illness. *See Kush v. Lloyd*, 616 So. 2d 415, 422 (Fla. 1992). The Florida Supreme Court has stated that "the underlying basis for the [impact] rule is that allowing recovery for injuries resulting from purely emotional distress would open the floodgates for fictitious or speculative claims." *R.J.*, 652 So. 2d at 362.

The Florida Supreme Court has, however, in a limited number of instances, either recognized an exception to the impact rule or found it to be inapplicable. In *Kush v. Lloyd*, the Court noted that the impact rule generally "is inapplicable to recognized torts in which damages often are predominately emotional," such as defamation and invasion of privacy. *Kush*, 616 So. 2d at 422. *See Time Ins. Co. v. Burger*, 712 So. 2d 389 (Fla. 1998) (within narrowly defined statutory parameters, emotional distress damages not subject to proof under impact rule); *Tanner v. Hartog*, 696 So. 2d 705 (Fla. 1997) (impact rule inapplicable to claim for negligent stillbirth); *Kush v. Lloyd*, *616 So. 2d 415 (Fla. 1992)* (impact rule inapplicable to parents' claim for wrongful birth of their severely deformed child); *Champion v. Gray*, 478 So. 2d 17, 20 (Fla. 1985) (claimant "who, because of his relationship to [an] injured party and his involvement in the event causing that injury, is foreseeably injured," is not required to prove impact upon his person but is required to show proof of emotional distress in form of discernible physical illness or injury).

Unfortunately, existing Florida Supreme Court precedent in ***Gracey v. Eaker***, 837 So. 2d 348 (Fla. 2002), supports the awardability of consequential bad faith/breach of fiduciary duty damages. In *Gracey*, the court stated, in pertinent part, that "a

fiduciary relationship exists between persons when one is under a duty to act for or give advice for the benefit of another upon matters within the scope of the relationship. *One in such a fiduciary relationship is subject to legal responsibility for harm flowing from a breach of fiduciary duty imposed by the relationship."* It is important to note that *Gracey* is not a bad faith case. Rather, *Gracey* dealt with a psychotherapist's violation of the patient confidentiality privilege. Nonetheless, due to *Tiara* stripping away the economic loss rule as a defense to a separate breach of fiduciary claim -and with the *Gracey* precedent - the specific rule requiring the impact rule for emotional distress or non-economic damages, has been vitiated. No longer will bad faith claimants have to prove impact to claim consequential "bad faith" damages premised under a breach of fiduciary duty claim.

Defenses

Breach of fiduciary duty claims are, in essence, typically nothing more than a re-assertion of bad faith allegations, but given a different title. Multiple courts in Florida have held that in the insurance context, a plaintiff's bad faith claim is the sole legal remedy with respect to allegations of improprieties in the manner in which an insurance claim was handled. *See, e.g., Breedlove v. Hartford Life & Acc. Ins. Co.*, 2011 WL 6132254 (M.D. Fla. Dec. 9, 2011); *Trianon Condominium Ass'n, Inc. v. QBE Ins. Corp.*, 741 F. Supp. 2d 1327 (S.D. Fla. 2010); *Portofino South Condominium Ass'n Of West Palm Beach, Inc. v. QBE Ins. Corp.*, 664 F. Supp. 2d 1265 (S.D. Fla. 2009); *Isola Condo. Ass'n, Inc. v. QBE Ins. Corp.*, 2008 WL 5169458 (S.D. Fla. 2008); *Quadomain Condo. Ass'n, Inc. v. QBE Ins. Corp.*, 2007 WL 1424596 (S.D. Fla. 2007). These courts have held that because a bad faith claim encompasses and provides a remedy for alleged mishandling of an insurance claim, causes of action such as the implied duty of good faith and fair dealing are duplicative of and subsumed within the bad faith cause of action and therefore are not actionable themselves. *Id.*; *see also Harrison v. Digital Health Plan*, 183 F.3d 1235 (11th Cir. 1999) (affirming dismissal of breach of fiduciary duty claim as duplicative of different cause of action in complaint); *Taylor v. Dean*, 2006 WL 4756452, *4-5 (M.D. Fla. Oct. 25, 2006) (dismissing two causes of action as being duplicative of other causes of action contained in the complaint).

In light of *Tiara*, insurance carriers should be aware of plaintiffs disguising bad faith allegations as breach of fiduciary duty claims. Claims professionals and counsel should seek a ruling that there is no fiduciary duty owed to an insured. Insurers should not admit that such a relationship exists.

Practice Point

The *Tiara* decision is a major win for the plaintiff's bar. The severe limitation of the economic loss rule will surely result in a significant increase in the number of tort claims and litigation in general. Pursuant to the Court's decision, every contract claim may now be accompanied with a tort claim even if the damages are only economical in nature. Accordingly, insurers and commercial parties in general, will be exposed to a plethora of tort claims, which were previously barred by the economic loss rule, in addition to the contract claims that existed prior to the Court's decision. The Court's decision undermines contract law in that one party to a contract may circumvent the allocation of loss set forth and agreed to in the contract by bringing a tort action.

The Court's decision will affect insurers with respect to claims made directly against them, as well as with respect to third party claims against a carrier's insured. When an insured is forced to go through litigation and has a judgment entered against it, the insured is now able to allege emotional distress damages. Insureds can now bring tort claims against their insurers, as opposed to just bad faith claims requesting damages for excess judgments.

Florida carriers will inevitably have to increase insurance premiums to account for the increased risk and exposure resulting from the *Tiara* decision. While *Tiara* does not seem to have a national impact yet, the Florida Supreme Court's ruling in *Tiara* will likely open the door to a flood of claims across the country. In every bad faith claim, we predict that there will be a breach of fiduciary duty claim with the possibility a jury awarding both economic and non-economic damages without limitations.

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Oregon's duty to defend rules: Proper Application in the summary judgment context and the proper role of Casey v. N.W. Security Ins. Co.

In Oregon, a court examines two documents to determine whether an insurer has a duty to defend an action against its insured: the insurance policy and the complaint in the action against the insured. *Marleau v. Truck Insurance Exchange*, 333 Or 82, 89, 37 P3d 148 (2001). As the Oregon Supreme Court explained:

"An insurer has a duty to defend an action against its insured if the claim against the insured stated in the complaint could, without amendment, impose liability for conduct covered by the policy

"In evaluating whether an insurer has a duty to defend, the court looks only at the facts alleged in the complaint to determine whether they provide a basis for recovery that could be covered by the policy[.] * * * An insurer should be able to determine from the face of the complaint whether to accept or reject the tender of the defense of the action.

"The insurer has a duty to defend if the complaint provides *any basis* for which the insurer provides coverage. Even if the complaint alleges some conduct outside the coverage of the policy, the insurer may still have a duty to defend if certain allegations of the complaint, without amendment, could impose liability for conduct covered by the policy. Any ambiguity in the complaint with respect to whether the allegations could be covered is resolved in favor of the insured."

Ledford v. Gutoski, 319 Or 397, 399–400, 877 P2d 80 (1994) (emphasis in original; citations omitted).

Regardless of the presence of ambiguity or unclarity in the complaint, the key question is whether the court can reasonably interpret the allegations to include an incident or injury that falls within the coverage of the policy. *Blohm et al v. Glens Falls Ins. Co.*, 231 Or 410, 416, 373 P2d 412 (1962). As observed in *Marleau*, "[N]either the failure to identify correctly the claims nor the failure to state them separately defeats the duty to defend." 333 Or at 91. As long as the complaint contains allegations that, without amendment, state a basis for a claim covered by the policy, the duty to defend arises. *Id*. The inclusion in the complaint of other allegations describing claims that fall outside the policy's coverage is immaterial. *See Abrams v. General Star Indemnity Co.*, 335 Or 392, 400, 67 P3d 931 (2003) (if the complaint contains allegations of covered conduct, the insurer has a duty to defend even if the complaint also contains allegations of excluded conduct). Any ambiguity concerning potential coverage is resolved in favor of the insured. *Ledford*, 319 Or at 400.

These well-settled principles were recently discussed in *Bresee Homes, Inc. v. Farmers Ins. Exchange*, 353 Or 112, 293 P3d 1096 (2012). There, Bresee Homes, Inc. (Bresee) sued Farmers Insurance Exchange (Farmers), which issued a commercial general liability (CGL) policy liability to Bresee, alleging that Farmers breached its duty to defend against claims brought by the Joneses against Bresee arising from work performed by one of Bresee's subcontractors on the Joneses' home.

Farmers filed a motion for summary judgment and argued that the "products—completed operations hazard" endorsement included in the CGL policy precluded any liability to Bresee. Bresee filed a cross-motion for partial summary judgment and argued that the endorsement did not apply and that, even if it did, the court should conclude that the Joneses' complaint against Bresee, reasonably construed, could be read to include a covered loss, *i.e.*, property damage occurring before completion of construction and damages arising from the failure of a product installed by a subcontractor.

The trial court granted Farmers' motion for summary judgment and denied Bresee's cross-motion for partial summary judgment concluding that Bresee, in submitting evidence on summary judgment, had not established when Bresee's subcontractor had completed the work and when the alleged damage had occurred. The Oregon Court of Appeals affirmed the trial court's duty to

defend decision.

The Supreme Court reversed. In doing so, it made clear: (1) the proper application of Oregon's duty to defend rules in the context of a motion for summary judgment, an application that, according to the court, the Court of Appeals got wrong; and (2) the limits of *Casey v. N.W. Security Ins. Co.*, 260 Or 485, 489, 491 P2d 208 (1971).

In addressing the first issue, the Supreme Court initially observed:

"The Joneses' allegations do not state whether the claimed damages from [Bresee's] alleged breach of contract and negligence occurred before or after the completion of Bresee's work. From all that appears from a reading of the complaint, the described property damage occurred, or could have occurred, when Bresee's work was neither completed nor 'deemed complete' under the 'products—completed operations hazard,' as defined in the policy.

"Farmers argues that this court should conclude that the property damage alleged in the Joneses' complaint occurred after Bresee completed its work, in part because that complaint was filed in 2005 and used verbs in their past tense (*e.g.*, 'flashing was not properly installed,' 'the exterior synthetic stucco system failed') to describe the alleged deficient performance. We are not persuaded. The allegations describe events and damage that occurred in the past, but which could have occurred at any time after contract execution. The allegations describing past deficient performance and damage do not necessarily say anything about the date Bresee completed its work.

The Joneses' allegations also do not permit this court to conclude that the alleged damage arose from Bresee's work that 'may [have] need[ed] service, maintenance, correction, repair or replacement but which is otherwise complete' within the meaning of the 'products—completed operations hazard' definition. The allegations say nothing about whether Bresee's work was 'otherwise complete,' or whether Bresee's work might need service, maintenance, etc., to be regarded as completed."

353 Or at 122-23. The court then rejected Farmers' argument that Bresee bore the burden of submitting evidence demonstrating that the work was not completed when the alleged property damage occurred, in order to avoid the effect of the 'products—completed operations hazard' exclusion. The court said:

"That is not correct. With regard to the duty to defend, Bresee has no burden to come forth with facts beyond those alleged in the Joneses' complaint. Those allegations stated the pertinent facts when Bresee tendered the Joneses' claims to Farmers and requested a defense. Our analysis of the duty to defend focuses on those allegations whether or not different or additional facts might be adduced at trial."

Id. at 123. Finally, the court corrected the Court of Appeals' analysis of Farmers's motion for summary judgment:

"As noted, the Court of Appeals observed that Farmers had presented some evidence in support of its motion for summary judgment indicating that "Bresee had completed work on the Joneses' home in 1999, and that Bresee had presented no contradictory evidence that the claimed damage had occurred before Bresee had completed its work. The Court of Appeals concluded, as a result, that the record contained no issue of fact on that question and that Farmers was entitled to summary judgment. The court reasoned that Bresee had a specific burden to produce evidence that an exception (i.e., damage arising out of uncompleted work) to the exclusion—the 'products—completed operations hazard'—applied.

"The Court of Appeals was mistaken in that analysis. Farmers relied on facts concerning the completion of Bresee's work that were not alleged in the Joneses' complaint. Farmers could discern from facts alleged by the Joneses and from its policy that the Joneses potentially could prove that the claimed damage arose before Bresee completed its work. When Bresee tendered the Joneses' complaint for defense, the factual question of whether the claimed damages had occurred before or after the completion of Bresee's work was an issue that the litigation between the Joneses and Bresee might determine, and, once established, could affect Farmers's duty to indemnify Bresee. *The potential factual determinations in that litigation, however, are not the facts that governed Farmers's duty to defend Bresee. When Bresee*

tendered the Joneses' claims, only the facts alleged by the Joneses and the terms of the Farmers policy governed Farmers's duty to provide a defense."

Id. at 123-24 (emphasis added; internal citation omitted).

In addressing the second issue, the court rejected Farmers' argument that that the court's analytical focus in duty to defend cases is not confined strictly to the insurance policy and the underlying complaint, because the court's cases had "left the door open for consideration of other 'compelling evidence of no coverage' outside the complaint that would nullify a duty to defend [in] *Casey*." 253 Or at 124. The court said that "the qualification that *Casey* recognized is a narrow one and has no application here," noting:

In *Casey*, the insured drove his automobile into Shelton, causing injuries. Shelton sued the insured, alleging assault and battery. He then amended his complaint to also allege negligence. Ordinarily, the alleged facts would have been sufficient to state a claim covered by the insured's automobile liability policy, and thus, the facts would have given rise to the insurer's duty to defend the insured against Shelton's claim. This court, however, considered other evidence in the record. That evidence demonstrated that, before Shelton filed his complaint, the insured had been criminally prosecuted for his conduct and had been convicted of intentionally injuring Shelton with his automobile. The court held that that evidence was available for consideration because it established beyond dispute that the insured was estopped to assert that he did not act intentionally in injuring Shelton. 260 Or at 490-92. The court declined to permit the insured to relitigate a key factual issue that the criminal prosecution already had conclusively resolved against him. The incontrovertible determination that the insured had no insurance coverage, and thus, the insurer had no duty to defend. *Id.* at 492.

"This case involves no court determination that precludes coverage like the criminal court adjudication considered in Casey. This court has consistently focused its analysis on the policy and the underlying complaint, and we adhere to that approach in this case."

253 Or at 124-25 (emphasis added; internal citation omitted). *Accord State Farm Fire & Cas. v. Reuter*, 299 Or 155, 160, 700 P.2d 236 (1985) (applying *Casey* in issue preclusion context).

After *Bresee*, it is clear that: (1) Oregon's usual duty to defend rules apply in the summary judgment context; (2) the only "material facts" properly considered by a trial court in a motion for summary judgment filed in a breach of the duty to defend case are the underlying complaint and the involved policy; and (3) *Casey*'s "compelling evidence of no coverage" exception is properly confined to when the adjudication of an issue precludes an insured from arguing that a court is limited to considering only the underlying complaint and policy in deciding a duty to defend issue.

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The duty to defend: Hiring defense counsel isn't enough

In a case demonstrating the old adage that bad facts make bad law, or in this case, sloppy conduct by an insurance company creates problems for all insurers, an Illinois Appellate Court has ruled that an insurer can be liable for the full amount of a default judgment entered against its insured when the attorney it retained to defend the insured allowed the default to be entered and did nothing to have it vacated.

In *Delatore v. Safeway Ins. Co.*, 2013 IL App (1st) 120852 (Ill. App. 1st Dist. 4/17/2013), the court affirmed summary judgment for the insured in the full amount of a $250,000 default judgment entered against the insured based on the insurer's breach of the duty to defend. This case arose from an auto accident which injured the driver and passenger of the other car, both of whom sued the driver. The defendant driver was insured by Safeway, with limits of $20,000 per person, $40,000 per accident. The insured driver tendered the defense to Safeway, which accepted the defense and advised the insured that it had retained an attorney to represent the driver in the suit. The attorney retained by the insurer entered an appearance and answer on behalf of the

insured, and filed written discovery. However, there was no evidence that after this initial response the defense counsel took any other action to defend the insured. The plaintiffs also propounded discovery to the defendant, and defense counsel did not respond to it. The plaintiffs moved for sanctions, and eventually, when defense counsel did nothing to respond, the court ordered a default against the defendant as a discovery sanction. Safeway received a copy of the default order, and sent it to defense counsel, but did nothing to follow up to ensure that the default was vacated.

At the same time, Safeway was unsuccessfully pursuing a rescission case against the insured driver, arguing that the insured had misrepresented his marital status on his application for coverage. After learning that the insurer had lost the rescission action, the insured and the plaintiffs reached an agreement whereby the insured assigned its rights against Safeway to the plaintiffs. The plaintiffs then sued Safeway, in the name of the insured, alleging that Safeway had breached the duty to defend the insured when it did nothing to ensure that defense counsel was adequately defending the suit.

Safeway was willing to pay its coverage limits to the plaintiffs, but its limits were clearly insufficient to satisfy the judgment. The insured argued that due to Safeway's breach of the duty to defend, Safeway was liable for the full amount of the judgment. Essentially, the insured argued that if the attorney retained by Safeway had not neglected the case, no default judgment would have been entered, and the insured would not have been liable for an excess verdict. Safeway responded with two arguments: first, it maintained that it did not breach the duty to defend, since it had accepted the defense and retained defense counsel; second, it claimed that even if it did breach the duty to defend, under Illinois law, a breach of the duty to defend will only lead to liability in excess of the insurer's limits if the breach is in bad faith. The court rejected both of these arguments.

In considering whether Safeway had breached its duty to defend, the court recognized that this case was substantially different than most Illinois cases in which insurers have been found to breach the duty to defend. In most cases, the insurer refuses to defend. Under Illinois law, when an insurer does not believe that it has coverage, it has two options. It can either defend the suit under a reservation of rights or it can file an action against the insured seeking a declaration that it has not duty to defend. If it fails to do either, and is later found to have had a duty to defend, it will be estopped from denying coverage. *Employers Ins. v. Ehlco Liquidating Trust*, 186 Ill. 2d 127, 150, 708 N.E.2d 1122 (1999). In contrast to the typical estoppel case, Safeway informed the insured that it would defend the case and retained an attorney, who then entered an appearance and answer for the insured.

The court noted that an earlier Illinois appellate court decision, *Brocato v. Prairie State Ins. Ass'n*, 166 Ill.App. 3d 986, 520 N.E.2d 1200 (Ill.App. 4th Dist. 1988), had found that when an insurer retained counsel for the insured to defend the case, it had fulfilled its duty to defend. The court distinguished *Brocato* on the basis that defense counsel in *Brocato* had "actually defended" the insured through trial. The court noted that it could not conceive of any definition of the term "actual defense" which included the actions of defense counsel in *Delatore*. Although he did enter an appearance and answer and initiate some discovery, he took no further action on behalf of the insured defendant in the ensuing three years during which the litigation was pending, even after a default was entered against the insured. Moreover, Safeway admitted that defense counsel had never submitted any statements of legal work he was performing or had performed on the insured's behalf. Thus, the court concluded that defense counsel had not provided an "actual defense."

The court was not content simply to distinguish *Brocato*, characterizing its conclusion that an insurer discharges its duty to defend solely by retaining an attorney for the insured as "troubling." The court was concerned that this holding would allow an insurer to escape its obligation to provide good faith representation and "freely abandon its insured to an attorney who is either unwilling or unable to undertake a defense, or who … inexplicably deserts the client." The court stated that the insurer's duty was "to *defend*, not merely to provide representation, and it is an ongoing duty throughout the

litigation." Since Safeway apparently did little more than retain the attorney and send the attorney a copy of the default order after it was entered, it had not fulfilled this duty.

The court rejected Safeway's argument that its holding would require the insurer to practice law in violation of Illinois law, stating that it failed to see how requiring an insurer to ascertain whether an insured is actually being defended constituted the practice of law.

Safeway also argued that the damages in the case should not exceed its policy limits because it had not acted in bad faith. Previous Illinois cases had held that where an insurer refuses to defend the insured and fails to file a declaratory judgment, it would only be liable for a judgment in excess of its limits if its refusal to defend was in bad faith. *E.g., Conway v. Country Casualty Ins*. Co., 92 Ill. 2d 388, 442 N.E.2d 245 (1982). However, the court noted that in Conway, the Illinois Supreme Court had specified that damages resulting from a breach of the duty to defend are "are not inextricably imprisoned within policy limits." Thus, the court in *Delatore* found that an insurer could be found liable in excess of its policy limits in two ways: (1) a tort based, punitive measure where the insurer acted in bad faith; and (2) as a compensatory measure where the insured's damages were proximately caused by the insurer's breach of the duty to defend. The court concluded that in this case, if the insurer had adequately defended the insured, there would have been no default judgment, and therefore the insured would not have been on the hook for such a significant excess judgment. Thus, the full judgment was proximately caused by the insurer's failure to properly defend.

In dissent, Justice Sterba argued that the majority's conclusion regarding proximate cause was flawed because it framed this issue as whether the default was caused by the insurer's actions. However, the better question was whether the judgment against the insured would have been less if the insurer had properly defended, and plaintiff had not shown that a lesser amount would have been entered.

The court's decision in *Delatore* is cause for serious concern. While the facts in *Delatore* are somewhat unique, and the insurer's inaction seems hard to explain, a broad reading of the case suggests that the insurer can be found liable, and lose the protection of its policy limits, if it fails to properly supervise defense counsel's actions.

Significantly, this is not the first case in which a court has reached such a conclusion. In *McGrath v. Everest Nat'l Ins. Co.*, 668 F. Supp. 2d 1085 (N.D.Ind. 2009), the court considered a situation in which the insurer had retained defense counsel who had allowed a default judgment in the amount of $15.8 million to be entered against the insured in a slip and fall case. When defense counsel's efforts to vacate the default were unavailing, the underlying plaintiff and the insured entered into an agreement to settle the underlying case for approximately $12 million. As in *Delatore*, the court in *McGrath* rejected the argument that the insurer fulfilled its duty to defend when it retained defense counsel to defend the insured.668 F.Supp. 2d at 1101. Also like *Delatore*, the court in *McGrath* ruled that the insured was entitled to damages in the full amount of the settlement reached by the insured after the default was entered, without regard to the insurance policy limits. *Id*. at 1107.

The situations in both *Delatore* and *McGrath* are substantially different than the vast majority of cases being defended by insurance companies for their insureds. Insurers generally retain competent counsel, and then insist on frequent reporting concerning developments in the defense of the case, with the result that defaults due to neglect by defense counsel are rare. Nevertheless, these cases indicate that it is not sufficient merely to retain defense counsel and then assume all is well. The *Delatore* and *McGrath* decisions suggest that courts will attribute the negligence of defense counsel to the insurer unless the insurer can demonstrate that it took appropriate actions to supervise defense counsel and ensure that the insured receives a competent defense.

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