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# INSURANCE COVERAGE ACTIONS: WHO, WHERE, AND WHEN TO SUE

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## INTRODUCTION

Recent years have seen a marked increase in the vulnerability of employers to a variety of claims by former employees. In addition to federal actions for discrimination under statutes such as the Civil Rights Act of 1964,<sup>1</sup> the Age Discrimination in Employment Act of 1967 ("ADEA"),<sup>2</sup> the Equal Pay Act,<sup>3</sup> and the Americans with Disabilities Act,<sup>4</sup> a broad array of state statutory and common law causes of action can give rise to claims as well. Common law tort suits may raise claims under diverse theories including wrongful and retaliatory discharge, breach of contract, defamation, and intentional or negligent infliction of emotional distress.

All of these kinds of lawsuits, whether asserted by a present or former employee, raise difficult issues of how to defend and handle a claim. In addition, these claims raise important insurance and risk management issues and require coordination among human resource personnel, risk managers, and labor and insurance lawyers.

In this Article, we review some basic issues that must be considered in bringing an action for insurance coverage, particularly where coverage for employee claims against employers are at issue. The Article assumes that the company has already given an insurer appropriate notice of a claim and that the insurer has reserved its rights to disclaim coverage on a variety of grounds.

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1. 42 U.S.C. §§ 2000e-2000e-17 (1988 & Supp. V 1993).
2. 29 U.S.C. §§ 621-634 (1988 & Supp. V 1993).
3. 29 U.S.C. § 206(d) (1988).
4. 42 U.S.C. §§ 12101-12117 (1988 & Supp. V 1993).

## I. THE IMPORTANCE OF FORUM SELECTION

One of the most difficult and significant issues in bringing an action for insurance coverage is the determination of where to file suit. The issue is critical because the choice of forum normally governs choice of law, and the determination of which law applies to a particular issue can frequently be outcome determinative.

A simple example illustrates the problem. Assume, for instance, that a large multistate corporation domiciled in Illinois purchases an insurance policy from an Illinois insurance company through an Illinois broker and that the policy provides comprehensive general liability coverage for occurrences arising anywhere in the United States. Assume further that the corporation has a plant in Texas and is sued for compensatory and punitive damages for wrongful discharge of an employee in Houston.

Focusing on the issue of punitive damages alone, the selection of controlling law may be outcome determinative. Though subject to exceptions, Illinois law is generally viewed as not permitting insurance coverage for punitive damages arising out of the insured's own misconduct.<sup>5</sup> Texas law, on the other hand, normally yields the opposite result.<sup>6</sup> Thus, to the extent it controls choice of forum and consequently choice of law, the forum selection process may ultimately determine whether the insured can obtain coverage for punitive damages or not.

The importance of forum selection is not limited to the insurability of punitive damages. Controlling legal principles pertaining to a number of critical issues in insurance coverage litigation vary significantly from state to state. These include the determination of what policy is triggered by a particular occurrence,<sup>7</sup> whether administrative proceedings give rise to a duty to defend,<sup>8</sup> how responsibility is to be allocated among multiple policies if more than one must

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5. *Beaver v. Country Mut. Ins. Co.*, 420 N.E.2d 1058, 1061 (Ill. App. Ct. 1981) (Illinois may permit insurance for punitive damages based on vicarious liability). See *International Surplus Lines Ins. Co. v. Pioneer Life Ins. Co.*, 568 N.E.2d 9, 15 (Ill. App. Ct. 1990), *appeal denied*, 580 N.E.2d 116 (1991).

6. See *American Home Assurance Co. v. Safeway Steel Prods. Co.*, 743 S.W.2d 693, 703-04 (Tex. Ct. App. 1987). See generally BARRY R. OSTRAGER & THOMAS R. NEWMAN, *HANDBOOK ON INSURANCE COVERAGE DISPUTES* § 14.06 (7th ed. 1994).

7. Compare, e.g., *Castle & Cooke, Inc. v. Great Am. Ins. Co.*, 711 P.2d 1108, 1113 (Wash. Ct. App.) ("pattern or practice" discrimination triggers every policy in effect during the pattern or practice), *rev. denied*, 105 Wash. 2d 1021 (1986) with *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 59 (3d Cir. 1982) (limiting coverage to the policy in effect when the injury from the pattern or practice first manifested itself).

8. See *infra* notes 72-79 and accompanying text.

respond to a particular loss,<sup>9</sup> the meaning of “expected and intended,”<sup>10</sup> and whether insurance for certain conduct is contrary to public policy.<sup>11</sup> In the context of D&O insurance, different states apply different legal principles in determining the extent to which defense or settlement costs of a corporation may be allocated to officers who are covered by the policy.<sup>12</sup>

The diversity of legal principles that various states apply to control key legal issues is further complicated by the substantial variation in applicable choice of law principles. If every state utilized the same choice of law principles, jurisdictional variations in the laws governing key coverage issues would have little relevance to forum selection; different jurisdictions applying the same choice of law principles would theoretically yield the same results. The fact is, however, that there is substantial variation among jurisdictions with respect to choice of law principles.

For this reason, the selection of the proper forum for asserting an action for insurance coverage frequently presents a tortuous analytical road. For each potentially available jurisdiction, the putative plaintiff must first consider the choice of law principles that will be applied by that forum and then look at the law of the various jurisdictions to which application of the governing choice of law principles is likely to lead. The problem is further compounded by the fact that under most choice of law principles, different jurisdictions may control different issues in the same coverage case.<sup>13</sup> Thus, forum selection requires a three-step analysis of: (1) where the party can sue, (2) what choice of law principles would be applied to critical legal issues in potentially applicable jurisdictions, and (3) which of these jurisdictions would apply the most favorable substantive law on each critical issue.

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9. Compare, e.g., *Continental Casualty Co. v. Aetna Casualty & Sur. Co.*, 823 F.2d 708, 712 (2d Cir. 1987) (prorating responsibility in the ratio that the insured's limits bear to the sum of all available coverage) with *Reliance Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, 753 F.2d 1288, 1292 (4th Cir. 1985) (applying the “equal share” method of apportioning responsibility).

10. See *infra* notes 88-98 and accompanying text.

11. See *infra* notes 131-44 and accompanying text.

12. See, e.g., *Nordstrom, Inc. v. Chubb & Son, Inc.*, 54 F.3d 1424, 1431-33 (9th Cir. 1995); *Harbor Ins. Co. v. Continental Bank Corp.*, 922 F.2d 357, 368 (7th Cir. 1990).

13. See, e.g., RESTATEMENT (SECOND) CONFLICT OF LAWS § 6 cmt. f (1971); *In re Air Crash Disaster near New Orleans, Louisiana on July 9, 1982*, 821 F.2d 1147, 1169 n.38 (5th Cir. 1987) (en banc).

## II. WHO SHOULD BE SUED?

Of course, prior to beginning the forum selection analysis the plaintiff must determine who to sue. For a policyholder seeking to obtain insurance coverage through litigation, the basic choices are generally limited to insurers and brokers.<sup>14</sup>

### A. *Insurers*

The determination of which insurer to sue is, in most cases, relatively straightforward. The policyholder must sue the insurer from whom coverage is being sought. In the simple wrongful discharge case, where the former employee is suing for \$500,000 with respect to an incident or series of incidents that took place over a three-month period, the likelihood is that coverage is available from only a single insurer, and that insurer is the only logical defendant in a coverage action.

This simple scenario can be complicated in a number of ways. The most obvious complication is when the action involves, or may involve, more substantial dollars, and an excess insurer must be included as a defendant in addition to the policyholder's primary carrier.

A second complication occurs when the incident at issue spans multiple policy periods. In some cases, this may be because acts of alleged discrimination span a number of years in which various policies were in effect. A pattern or practice of discrimination, for example, may trigger every policy in effect from the beginning to the end of the pattern or practice.<sup>15</sup>

A suit against multiple insurers may also be appropriate where several different types of policies potentially cover a loss. Consider, for example, the situation in which a company and senior officer who are sued for wrongful discharge may have coverage from a Commercial General Liability ("CGL") policy, an Employer Practices Insurance Liability ("EPLI") policy and a D&O Policy. Each insurer that issued one of these policies is a potential defendant.

Typically, an insured is well advised to sue all potentially re-

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14. Where an insurer is insolvent, a claim against a guaranty fund or a liquidator may also be appropriate. Detailed discussion of such claims can be found in A.B.A., *Law and Practice of Insurance Company Insolvency Revisited* (1989).

15. See, e.g., *Transport Ins. Co. v. Lee Way Motor Freight, Inc.*, 487 F. Supp. 1325, 1327-28 (N.D. Tex. 1980); *Castle & Cooke, Inc. v. Great Am. Ins. Co.*, 711 P.2d 1108, 1113 (Wash. Ct. App.), rev. denied, 105 Wash. 2d 1021 (1986). But see *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 59 (3d Cir. 1982) (limiting coverage to the policy in effect when the injury from the pattern or practice first manifested itself).

sponsible insurers. This avoids the dangers of multiple lawsuits and inconsistent rulings and may help to avoid an inadvertent failure to sue a carrier from which coverage is actually available.

### B. *Brokers and Agents*

A broker on which the insured relied in obtaining the relevant insurance is also a potential defendant in a coverage action. Suits against the broker typically arise in two situations.<sup>16</sup>

First, the insured may have believed it was purchasing insurance that would protect it from a discrimination or wrongful discharge case. The corporate risk manager's files may disclose that the broker was specifically asked for this kind of coverage. If the insurer has taken the position that it did not issue such coverage, the insured may have an action against the broker for failing to obtain the coverage that was anticipated. Particularly where the broker is ambivalent about the availability of coverage, filing a lawsuit against the broker may create a significant incentive for the broker to become more supportive of the policyholder's coverage claim.

A second situation in which it may be appropriate to sue a broker is where an insurer that provided coverage is insolvent. In some jurisdictions, the broker may be sued for negligent misrepresentation or for negligence in failing to advise the insured of the risks inherent in purchasing coverage from a particular carrier.<sup>17</sup> In many states, where coverage is purchased on an excess and surplus basis, the broker has specific statutory responsibilities to advise the insured of the nature of the insurance coverage and of the policyholder's inability to secure protection from state guarantee funds.<sup>18</sup>

A decision to sue a broker should always be made with extreme care. In many cases, the broker knows far more about the nature and history of the insurance coverage than the policyholder does. More importantly, the broker often controls the relationship with the insurers and can be an important ally to the policyholder in trying to convince the insurer to provide coverage and in attempting to mediate settlement discussions. Obviously, the broker's willingness to fulfill these roles may be undermined significantly if it is

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16. For further discussion of suits against insurance brokers or agents, see OSTRAGER & NEWMAN, *supra* note 6, § 18.04; Burke A. Christensen, *Insurance Agent or Broker Liability to the Insured*, 10 J. INS. REG. 313 (Spring 1992).

17. See, e.g., *Carter Lincoln-Mercury, Inc. v. EMAR Group, Inc.*, 638 A.2d 1288, 1296-97 (N.J. 1994).

18. E.g., ILL. ANN. STAT. ch. 215, para. 5/445 (Smith-Hurd 1993).

a defendant in the lawsuit and tactically aligned with an insurer who claims that there is no coverage at all.

If the insured purchases its insurance not through a broker but through an agent of the insurer, the insured generally cannot sue that agent.<sup>19</sup> If, however, the insurer's agent acts as a dual agent for both the insured and the insurer, an action against the agent may be possible.<sup>20</sup> Factors that may affect the agent's status as a dual agent include whether the agent induced the insured to rely on the agent's advice and whether the agent developed and maintained a relationship with the insured.<sup>21</sup>

### III. WHERE CAN YOU SUE?

Once you determine the appropriate defendants, the next step is to determine where those defendants can be sued. The basic elements of the analysis are similar to those in any lawsuit: Where can you obtain jurisdiction over each defendant? Where is venue proper? What defenses to forum selection are likely to be encountered in forums where personal jurisdiction and venue are proper?

#### A. *Personal Jurisdiction*

Most major carriers do business in most major states and are therefore subject to personal jurisdiction under the general transacting business provisions of the relevant jurisdictional statutes. In addition, many states' long-arm statutes reach insurers contracting to insure a person, property, or risk in the forum state.<sup>22</sup>

In most cases, service can be obtained by serving the insurer at one of its offices or by service on a licensed carrier through the department of insurance in a particular state.<sup>23</sup> State statutes often provide that surplus line, foreign and alien insurers must appoint a state official as their agent for service of process.<sup>24</sup> Where a carrier is not subject to jurisdiction in a particular state, insurance policies frequently contain a consent to suit clause, which obligates the in-

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19. See RESTATEMENT (SECOND) OF AGENCY § 320 (1957).

20. See, e.g., Kurtz, Richards, Wilson & Co. v. Insurance Communicators Mktg. Corp., 16 Cal. Rptr. 2d 259, 263 (Cal. Ct. App. 1993), *reh'g and rev. denied*, 12 Cal. App. 4th 1249 (1993).

21. *Id.*

22. E.g., ILL. ANN. STAT. ch. 735, para. 5/2-209(a)(4) (Smith-Hurd 1993).

23. E.g., ch. 735, para. 5/2-204; N.Y. CIV. PRAC. L. & R. 311(1) (McKinney 1990).

24. E.g., ILL. ANN. STAT. ch. 215, para. 5/445(10) (Smith-Hurd 1993) (surplus line service of process statute); ch. 215, para. 5/112 (foreign and alien insurer service of process statute).

surer to accept service in any American jurisdiction.<sup>25</sup>

### B. *Subject Matter Jurisdiction*

State courts are courts of general jurisdiction, that typically have subject matter jurisdiction over most disputes where personal jurisdiction is proper. However, the issue of subject matter jurisdiction may be critical if a party wants to assert a coverage action in federal court.

In general, the only basis for accessing the federal courts in a coverage dispute will be diversity jurisdiction. To determine whether suit can be filed in federal court based on diversity jurisdiction, it is necessary to list the residence of the policyholder and of each potential defendant (a corporation resides, for diversity purposes, at its principal place of business and its place of incorporation).<sup>26</sup>

Assuming that the \$50,000 amount in controversy requirement of the diversity statute can be satisfied,<sup>27</sup> a federal forum is often available for coverage actions involving limited numbers of insurers. As the number of insurers increases, the likelihood also increases that one of the insurers will have the same place of incorporation or principal place of business as the policyholder and thereby destroy the possibility of diversity jurisdiction. This is particularly likely to be true if the policyholder is a major corporation incorporated in Delaware, because many insurers also are incorporated in that state.

It is important to recognize that it is the state of incorporation, not the state of licensing or regulatory domicile, that controls the determination of residence for diversity purposes. Foreign insurers, such as Lloyd's of London, which are not citizens of any American state, are subject to diversity jurisdiction in a suit with any American corporation,<sup>28</sup> so long as no other defendant destroys complete diversity.<sup>29</sup>

The determination of whether to sue in state or federal court may carry with it important tactical implications. If the policyholder wants its case heard in state court, it is obviously important to join non-diverse parties as defendants in order to eliminate the

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25. See *infra* notes 42-45 and accompanying text.

26. 28 U.S.C. § 1332(c) (1988).

27. § 1332(a).

28. § 1332(a)(2)-(3).

29. *Id.*; see also *Field v. Volkswagenwerk AG*, 626 F.2d 293 (3d Cir. 1980).



possibility of removal. Another possibility is to sue in a jurisdiction where one of the defendants resides. The federal removal statute does not allow removal of a suit based on diversity jurisdiction if *any* of the defendants resides in the state in which the suit is brought.<sup>30</sup> One of the important considerations in deciding whether to be in state or federal court is the recognition that cases in the federal system can be transferred to another venue,<sup>31</sup> while in state court the only possibility is a dismissal on grounds of forum non conveniens or transfer within the state.

### C. *Venue*

Assuming the availability of appropriate personal and subject matter jurisdiction, there remains the question of proper venue. The answer to the venue question varies considerably from jurisdiction to jurisdiction. Most jurisdictions, however, have rules that are similar to those found in the federal statutes under which venue is proper: (1) in any district in which any defendant resides; and (2) in any district in which "a substantial part of the events or omissions giving rise to the claim occurred."<sup>32</sup> In addition, although no analogue exists in federal law, many states have special venue provisions concerning insurance companies. In Illinois, for example, an action against insurers incorporated or doing business in Illinois may be brought in any county in which any plaintiff resides.<sup>33</sup> Thus, the law of each potentially available jurisdiction must be carefully checked to be certain that a forum is available in which venue is proper as to *any* parties that the plaintiff intends to include as defendants.

### D. *Disputes over Forum Selection*

Because of the importance of forum in insurance coverage litigation, the initial stages of a coverage case are frequently characterized by substantial disputes over the appropriateness of the

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30. The federal removal statute provides:

Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties. Any other such action shall be removable only if none of the parties in interest properly joined and served as defendants is a citizen of the State in which such action is brought.

28 U.S.C. § 1441(b) (1988).

31. §§ 1404, 1406.

32. § 1391(a) (Supp. V 1993).

33. ILL. ANN. STAT. ch. 735, para. 5/2-103(e) (Smith-Hurd 1993).

plaintiff's forum selection.<sup>34</sup>

Disputes over forum selection tend to be rather limited when a case is first filed in federal court because of the potential for transfer to a more appropriate district. Section 1404 of the United States Judicial Code permits a district court “[f]or the convenience of parties and witnesses [and] in the interest of justice, [to] transfer any civil action to any other district or division where it might have been brought.”<sup>35</sup> Though it may obviously have importance for tactical reasons, litigation under section 1404 is not normally important for choice of law purposes because an action properly brought in a particular venue, but subsequently transferred for reasons of convenience, continues to be treated for choice of law purposes as filed in the original venue.<sup>36</sup>

Where the venue in the forum in which the case was originally filed is improper, as opposed to merely inconvenient, a federal court can transfer the case to a proper venue pursuant to 28 U.S.C. section 1406. In the event of a transfer pursuant to section 1406, the case is treated as having been filed in the transferee court, and the choice of law principles of the transferee court will control.<sup>37</sup>

Because of the ability of federal courts to transfer cases from one district to another, the doctrine of forum non conveniens is rarely applicable in federal jurisprudence.<sup>38</sup> Most states, on the other hand, will consider a motion to dismiss on forum non conveniens grounds where the forum chosen by the plaintiff is “seriously” inconvenient, and the more convenient forum is in another state.<sup>39</sup>

Courts may be skeptical of forum non conveniens motions in situations in which issues are legal and not fact-intensive, and evidence is easily transported.<sup>40</sup> Thus, the doctrine of forum non con-

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34. See, e.g., *DeVries v. Bankers Life Co.*, 471 N.E.2d 230 (Ill. App. Ct. 1984).

35. § 1404a (1988).

36. *Ferens v. John Deere Co.*, 494 U.S. 516 (1990).

37. See, e.g., *Tel-Phonic Servs., Inc. v. TBS Int'l, Inc.*, 975 F.2d 1134, 1141 (5th Cir. 1992).

38. There may be situations in which the only insurance policy at issue is a policy issued outside of the United States by a foreign insurer. In this situation, forum non conveniens arguments may be possible at the federal level. See *American Dredging Co. v. Miller*, 114 S. Ct. 981 (1994).

39. See, e.g., *Anderson v. Great Lakes Dredge & Dock Co.*, 309 N.W.2d 539 (Mich. 1981). See generally 1 ROBERT C. CASAD, *JURISDICTION IN CIVIL ACTIONS* § 1.04 (2d ed. 1991) (discussing the application of forum non conveniens in state courts).

40. For example, in *Monsanto Co. v. Aetna Casualty & Surety Co.*, 559 A.2d 1301

veniens is most often applied in coverage cases involving blatant forum shopping.

Consider, for instance, our earlier example in which an Illinois corporation purchases an insurance policy from an Illinois insurer through an Illinois broker and sues for coverage with respect to a wrongful termination case where all the facts relevant to the termination take place in Texas. A policyholder may attempt to bring that action in Delaware because of some belief that it will obtain more favorable treatment of its case in that court. Our hypothetical case, however, has no connection with the state of Delaware. None of the evidence is anywhere near Delaware, none of the parties have had any relevant contact with the state of Delaware, and the state of Delaware and its citizens have little or no interest in the dispute. Under these circumstances, there is a serious possibility that a court would grant a motion to dismiss on grounds of forum non conveniens.

Because a state court cannot transfer an action to another jurisdiction, the doctrine of forum non conveniens requires a complete dismissal without prejudice, rather than the kind of transfer that might take place within the federal system. To avoid protracted litigation and potential forum non conveniens dismissal, many coverage plaintiffs focus their analysis of potentially available forums on jurisdictions that have some contact either with the issuance of the insurance policy at issue or with the underlying dispute. Mere incorporation or residency is not normally viewed as a sufficiently important contact, in itself, to resist a motion to dismiss on grounds of forum non conveniens.<sup>41</sup>

#### E. *Consent to Suit*

Another issue that is commonly considered in disputes over fo-

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(Del. Super. Ct. 1988), where the court denied the insurers' forum non conveniens motion, it distinguished insurance coverage cases from other cases:

Courts recognize that most of the issues in insurance coverage actions are legal in nature. The Court can resolve them with little or no live testimony. If the Court needed testimonial evidence the parties could gather the evidence in the form of depositions and transport it to Delaware. The original location of documentary evidence thus cannot defeat plaintiff's choice of forum. . . . Also, the size and financial resources available to the parties substantially attenuates these [substantial burden] concerns.

*Id.* at 1307 (citations omitted).

41. See also *Union Carbide Corp. v. Aetna Casualty & Sur. Co.*, 562 A.2d 15 (Conn. 1989) (upholding the dismissal of insured's coverage claim on grounds of forum non conveniens, even though insured's headquarters was located in the forum state).

rum selection concerns consent to suit clauses. The traditional consent to suit clause provides, in substance, that:

[I]n the event of the failure of Underwriters hereon to pay any amount claimed to be due hereunder, Underwriters hereon, at the request of the insured (or reinsured) will submit to the jurisdiction of any Court of competent jurisdiction within the United States and will comply with all requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such Court.<sup>42</sup>

Many policyholders have taken the position that such a clause precludes the insurer from asserting a motion to dismiss on grounds of forum non conveniens.<sup>43</sup> In several cases the insureds also have argued, sometimes successfully, that such a clause precludes the insurer from removing the action to federal court.<sup>44</sup>

Although these issues have given rise to hotly contested litigation at the trial and appellate levels, most major carriers have revised the consent to suit clause to indicate explicitly that the insurer retains the right to assert a motion for transfer or to remove to federal court. For example, policies currently issued by the London market provide that:

Nothing in this Clause constitutes or should be understood to constitute a waiver of Underwriters' rights to commence an action in any Court of competent jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another Court as permitted by the laws of the United States or of any State in the United States.<sup>45</sup>

#### F. *The Possibility of Arbitration*

A growing number of insurance policies, particularly high level excess policies issued in the Bermuda market, include provisions

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42. *E.g.*, *Price v. Brown Group, Inc.*, 619 N.Y.S.2d 414, 416 (N.Y. App. Div. 1994).

43. *E.g.*, *Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710, 717-18 (D.C. Cir. 1986), *cert. denied*, 479 U.S. 1060 (1987).

44. *Compare Foster v. Chesapeake Ins. Co.*, 933 F.2d 1207, 1216-17 (3d Cir.) (holding that the consent to suit clause precluded removal), *cert. denied*, 502 U.S. 908 (1991) *with In re Texas E. Transmission Corp.*, 15 F.3d 1230, 1242-44 (3d Cir.) (holding the consent to suit clause did not preclude removal), *cert. denied*, 115 S. Ct. 291 (1994). See generally *Foster*, 933 F.2d at 1216-17 and cases cited therein, discussing other cases involving removal and consent to suit clauses.

45. See John G. Hanlin, *The Traditional Service of Suit Clause: Choice of Forum and Law Provision?*, 39 FED'N INS. & CORP. COUNS. Q. 363, 375 (Summer 1989).

that explicitly require arbitration of coverage disputes. These arbitration clauses are typically enforced by the courts pursuant to mandates of state and federal arbitration statutes<sup>46</sup> and, in many cases, international treaties.<sup>47</sup> Because of the strong and frequently articulated judicial and public policy preference for arbitration, most state and federal courts will grant a motion to compel arbitration where a policyholder attempts to sue an insurer for coverage under a policy that includes an arbitration clause.<sup>48</sup>

### G. *Necessary and Indispensable Party Litigation*

Neither the Federal Rules of Civil Procedure nor the procedural rules of most states require a plaintiff to sue every possible defendant or to join every possible cause of action in a single case.<sup>49</sup> Thus, although it may be expensive and inefficient, some attorneys consider bringing separate actions in different forums against different carriers. The defense to this approach is a motion under Rule 19 of the Federal Rules of Civil Procedure, or its state court equivalent, for joinder. Rule 19 provides as follows:

A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest.<sup>50</sup>

If a person who should be joined as a necessary party under Rule 19(a) cannot be made a party, "the court shall determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent person being thus regarded as indispensable."<sup>51</sup>

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46. 9 U.S.C. §§ 1-16 (1988); *see also, e.g.*, CONN. GEN. STAT. § 38a-336(c) (1993).

47. *See* 9 U.S.C. §§ 201-08 (1988 & Supp. V 1993).

48. *See, e.g.*, *Heinhuis v. Venture Assocs.*, 959 F.2d 551 (5th Cir. 1992); *Preferred Mut. Ins. Co. v. Martinez*, 643 So. 2d 1101, 1102-03 (Fla. Dist. Ct. App. 1994).

49. *See* FED. R. CIV. P. 19(a); ILL. ANN. STAT. ch. 735, para. 5/2-405 (Smith-Hurd 1993).

50. FED. R. CIV. P. 19(a).

51. FED. R. CIV. P. 19(b). As noted below, not all states include an equivalent to

Arguments concerning the necessity of joining an indispensable party are typically raised in coverage cases in two situations. First, there may be a dispute over which of a number of potentially applicable policies should respond to a particular loss. In the employment context, this might occur where a policyholder has one policy in effect in 1994 and a second policy in effect in 1995 and is confronted with a lawsuit in which the plaintiff alleges a pattern or practice of discrimination that continued throughout both policy periods.<sup>52</sup>

Another paradigm for necessary party arguments concerns the situation in which there are multiple insureds under a particular policy. In this situation, a court may require joinder of the additional insureds so that they are bound by the outcome and cannot contest the depletion of applicable policy limits on a particular claim. This situation is most likely to occur where the relevant policy has some kind of aggregate limit that might be depleted by payment of a loss.

The decision of the court in *In re Forty-Eight Insulations, Inc.*<sup>53</sup> is illustrative. In that case, a bankrupt manufacturer of asbestos, Forty-Eight Insulations, sued numerous insurers for insurance coverage under policies purchased by Forty-Eight's corporate parent, Foster Wheeler Corporation. Because Foster Wheeler was an insured under each of these policies, the insurers were concerned that Foster Wheeler would not be bound by any determination of coverage issues in litigation with Forty-Eight that might result in exhaustion of policy limits. The district court, applying Rule 19(a)(2) of the Federal Rules of Civil Procedure, ordered Forty-Eight to join Foster Wheeler as a party defendant and held that "Foster Wheeler is a necessary party to this action under Rule 19(a)(2)(ii) because it claims an interest relating to the subject of this action, and its absence would subject the defendant insurers to a substantial risk of multiple or inconsistent obligations."<sup>54</sup>

Many of the cases on mandatory joinder in the insurance coverage context involve situations where the court has relied on Fed-

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FED. R. CIV. P. 19(a)(2) in their mandatory joinder rules. See *infra* note 56 and accompanying text.

52. *Compare*, *Castle & Cooke, Inc. v. Great Am. Ins. Co.*, 711 P.2d 1108, 1113 (Wash. Ct. App.) ("pattern or practice" discrimination triggers every policy in effect during the pattern or practice), *rev. denied*, 105 Wash. 2d 1021 (1986) with *Appalachian Ins. Co. v. Liberty Mut. Ins. Co.*, 676 F.2d 56, 62 (3d Cir. 1982) (limiting coverage to the policy in effect when the injury from the pattern or practice first manifested itself).

53. 109 B.R. 315 (N.D. Ill. 1989).

54. *Id.* at 319.

eral Rule 19(a)(2) or a similar state court rule.<sup>55</sup> It should be noted, however, that some states do not have an equivalent to Federal Rule 19(a)(2) and require joinder only where “[the party’s] presence in the action is essential to permit the court to render complete relief.”<sup>56</sup> Necessary joinder may be more unlikely under this standard.<sup>57</sup>

#### IV. WHERE SHOULD THE POLICYHOLDER OR INSURER SUE?

Once the potential plaintiff, whether it be an insurer or an insured, determines the jurisdiction in which a suit might properly be brought, the next question concerns the identification and selection of the preferred forum. This analysis will require consideration of many of the same factors that must be considered in determining where to file any lawsuit.

##### A. *Are Some Judges Better Than Others?*

There is a series of questions a sophisticated lawyer always asks in deciding which of several potentially available courthouses should be the forum for a new lawsuit: Does a particular judge or jurisdiction have particular biases for or against the parties involved? Are there any rules or procedures of a particular jurisdiction that are likely to make it more or less favorable to one’s case? What are the views of potential jurors in the jurisdiction about the kinds of issues and the parties that might be involved? (For example, a policyholder would be unlikely to want to assert a coverage action arising from a racial discrimination case in a black, working-class community.) Is the plaintiff interested in getting his case to trial quickly or slowly, and what is the backlog in potentially relevant jurisdictions?

All of these factors must be considered carefully and will vary from case to case and jurisdiction to jurisdiction. Although many of these issues will depend on subjective evaluations and attorney experiences with particular judges and courts, the issue of controlling law will require careful legal analysis.

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55. *Chesapeake & Ohio Ry. Co. v. Certain Underwriters at Lloyd’s, London*, 716 F. Supp. 27 (D.D.C. 1989), *rev’d on other grounds*, 910 F.2d 960 (D.C. Cir. 1990); *see also Seaside Resorts, Inc. v. Club Car, Inc.*, 416 S.E.2d 655, 665 (S.C. Ct. App. 1992).

56. *E.g.*, MCR 2.205(A) (West 1995) (Michigan).

57. *See Hofmann v. Auto Club Ins. Ass’n*, 535 N.W.2d 529 (Mich. Ct. App. 1995); *Troutman v. Ollis*, 351 N.W.2d 301, 305 (Mich. Ct. App. 1984).

## B. *Choice of Law*

Regardless of whether suit is brought in federal or state court, the law of the forum typically determines choice of law principles.<sup>58</sup> In a diversity case in federal court, conflict of laws issues concerning substantive matters are normally resolved by reference to the choice of law principles applied by the courts of the state in which the federal district court is located.<sup>59</sup> Although simple to state, these hornbook law principles can be extremely problematic because of the considerable variation in the choice of law principles used by various jurisdictions in insurance coverage litigation.

### 1. Traditional Approach: Place of Contracting

In deciding the controlling law with respect to insurance contract disputes, a number of states continue to use the approach established by the *Restatement (First) of Conflict of Laws* ("First Restatement") under which issues relating to the validity of a contract are determined by reference to the law of the place of contracting, and issues relating to the performance of the contract are governed by the law of the place of performance.<sup>60</sup>

The approach of the *First Restatement* typically focuses on where the contract at issue was executed and delivered, with the place of the last act necessary to complete the contract typically being viewed as the place of contracting.<sup>61</sup> Although this approach is supposed to have the advantage of certainty and predictability, it often yields substantial differences of opinion in insurance coverage disputes. For example, when an insurer in one state has issued a policy through an agent in a second state, who has delivered the policy to a broker in a third state, who has delivered the policy to an insured in a fourth state, substantial litigation over where the contract was delivered can result. The situation may be further complicated where the insured that is asserting coverage is a subsidiary of the company that bought the policy and is located in yet a fifth state. These kinds of situations can yield extensive litigation over where the policy was signed and countersigned, whether the broker was an agent of the insured, and related issues.

The complexities of the *First Restatement* approach are compounded by the fact that, unlike questions of contract construction

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58. 16 AM. JUR. 2d *Conflict of Laws* § 3 (1979 & Supp. 1995).

59. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941).

60. RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 332, 358 (1934).

61. 16 AM. JUR. 2d *Conflict of Laws* § 76 (1979 & Supp. 1995).



that are typically governed by the law of the place of contracting, questions related to the performance of the contract are typically governed by the law of the place of performance.<sup>62</sup> This dichotomy can raise endless litigation about whether a particular issue is a matter of contract validity or construction, on the one hand, or performance on the other. As a result, the law of one jurisdiction may control the issue of rescission, but the law of an entirely different jurisdiction might control issues such as late notice and the circumstances under which an insurer is relieved of its coverage obligation if notice is not given on a timely basis.

## 2. Second Restatement: Most Significant Contacts

Recognizing that the location where a contract is executed or an insurance policy is delivered may have little or nothing to do with the reasonable expectations of the parties about controlling law, a number of states have adopted more flexible choice of law principles. The most common of these is the most significant contacts test adopted by the *Restatement (Second) of Conflict of Laws* ("*Second Restatement*"). That approach, which is expressly oriented toward the reasonable expectations of the parties, focuses on a series of factors, including: (1) the needs of the interstate and international systems; (2) the relevant policies of the forum; (3) the relevant policies of other interested states and the relative interest of those states in the determination of the particular issue; (4) the protection of justified expectations; (5) the basic policies underlying the particular field of law; (6) certainty, predictability and uniformity of result; and (7) ease in the determination and application of the law to be applied.<sup>63</sup>

In attempting to apply these principles, the *Second Restatement* focuses on the number of contacts to determine the state with the most significant relationship to a matter. The contacts considered include the place of contracting, the place of negotiation, and the domicile, residence, nationality, place of incorporation, and place of business of the parties.<sup>64</sup>

The *Second Restatement* has a special rule for insurance contracts. Under section 193, "[t]he validity of a contract of fire, surety or casualty insurance and the rights created thereby are determined by the local law of the state that the parties understood was to be

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62. RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 358 (1934).

63. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971).

64. *Id.* § 188(2).

the principal location of the insured risk," unless another state has a "more significant relationship" under general conflict principles.<sup>65</sup>

Unfortunately, the focus on the principal location of the insured risk is extremely difficult to apply in the context of large multistate corporations. If a California insured with offices and employees in all fifty states purchases an insurance policy from a New York insurer and has a wrongful termination claim arising from its operations in Missouri or a discrimination claim arising from operations in several states, there may be no clear expectation of the parties as to the principal location of an insured risk. Although some courts may turn to the insured's principal place of business to resolve the issue, that approach may give way in other situations to a more significant relationship with the state where the underlying event leading to the covered occurrence took place. Several courts have accorded special significance to the location of the risk in choice of law determinations.<sup>66</sup>

Still other jurisdictions use a governmental interest approach to resolve conflicts of law.<sup>67</sup> The governmental interest approach emphasizes the interests of various jurisdictions in having their law resolve a particular dispute rather than the expectations of the parties. Several states, such as California and New Jersey,<sup>68</sup> utilize this approach. The governmental interest approach often tends to give greater emphasis to forum selection and the forum involved in the underlying risk.

### C. *Key Substantive Issues for Choice of Law Analysis*

Once there has been an identification of the forums in which suit can be filed and of the choice of law principles courts in those forums use to select controlling law with respect to particular issues, it is necessary to examine where the application of the relevant principles may lead. In the remainder of this Article, we identify some of the issues that may be worthy of consideration.

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65. *Id.* § 193.

66. *See, e.g.,* CPC Int'l, Inc. v. Northbrook Excess & Surplus Ins. Co., 46 F.3d 1211, 1217 (1st Cir. 1995); Glowski v. Allstate Ins. Co., 589 A.2d 593, 595 (N.H. 1991).

67. *See, e.g.,* Stonewall Surplus Lines Ins. Co. v. Johnson Controls, Inc., 17 Cal. Rptr. 2d 713, 718 (Cal. Ct. App. 1993); Veazey v. Doremus, 510 A.2d 1187, 1189 (N.J. 1986).

68. *Stonewall*, 17 Cal. Rptr. 2d at 718; *Veazy*, 510 A.2d at 1189. For a survey of the choice of law theories used by each jurisdiction, see Gregory E. Smith, *Choice of Law in the United States*, 38 HASTINGS L.J. 1041 (1987).

## 1. Duty to Defend

In many situations, the critical issue driving a coverage case is the policyholder's desire to obtain prompt insurance payment or reimbursement of defense costs. In most jurisdictions, the insurer must defend if the complaint at issue alleges some facts that are within the policy's coverage, even if the allegations are vague, groundless, false or fraudulent.<sup>69</sup> However, this is not the rule in all jurisdictions. For example, some courts may permit an insurer to avoid defense obligations if the insurer knows of facts, extrinsic to the complaint, that conclusively eliminate any potential for coverage.<sup>70</sup> The precise rule governing an insurer's defense obligation and the likelihood that the policyholder can obtain a defense based on a motion for summary judgment<sup>71</sup> may be key elements in determining the suitability of the law of a particular jurisdiction with respect to a particular case.

## 2. Duty to Defend in Administrative Proceedings

There is sometimes an issue as to how early an insurer's obligation to defend or to pay defense costs begins in a particular case. Many insurance policies avoid this problem by conditioning defense obligations on receipt of a complaint or commencement of a suit.<sup>72</sup> These kinds of situations may give rise to significant disputes in situations where judicial litigation is normally preceded by some kind of administrative procedure or demand.

One of the areas in which such disputes over defense obligations often arise is in the context of employment-related claims where resort to administrative agencies such as the Federal Equal Employment Opportunity Commission ("EEOC") or similar state agencies is mandatory.<sup>73</sup>

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69. *E.g.*, *Interco Inc. v. Mission Ins. Co.*, 808 F.2d 682, 685 (8th Cir. 1987) (applying Missouri law); *Trizec Properties, Inc. v. Biltmore Constr. Co.*, 767 F.2d 810, 812 (11th Cir. 1985) (applying Florida law); *Thornton v. Paul*, 384 N.E.2d 335, 339 (Ill. 1978). *See also* OSTRAGER & NEWMAN, *supra* note 6, § 5.02.

70. *E.g.*, *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 177 (Cal. 1966) (en banc); *Cincinnati Ins. Co. v. Mallon*, 409 N.E.2d 1100, 1105 (Ind. Ct. App. 1980).

71. *See, e.g.*, *Casso v. Brand*, 776 S.W.2d 551, 555-56 (Tex. 1989) ("Summary judgments in federal courts are based on different assumptions, with different purposes, than summary judgments in Texas.").

72. *See, e.g.*, *Society of Mount Carmel v. National Ben Franklin Ins. Co.*, 643 N.E.2d 1280, 1288 (Ill. App. Ct. 1994) ("[the insurer] shall have the right and duty to defend any *suit* against the insured") (emphasis added).

73. Under Title VII, a plaintiff must exhaust EEOC administrative remedies before bringing suit in a state or federal court. 42 U.S.C. § 2000e-5(f) (1988 & Supp. 1993). Many state antidiscrimination statutes also require administrative exhaustion

At least two courts have held that the duty to defend does not extend to complaints filed with the EEOC. In *Maryland Cup Corp. v. Employers Mutual Liability Insurance Co.*, the court held there was no duty to defend because the policy limited the insurer's defense obligations to suits "seeking damages," and the EEOC can only grant equitable relief.<sup>74</sup> *Campbell Soup Co. v. Liberty Mutual Insurance Co.*, held that an EEOC proceeding is not a "suit" and therefore cannot trigger a duty to defend.<sup>75</sup> These two cases illustrate the most common arguments against extension of a defense obligation to administrative proceedings.

In cases that do not involve rights of employees, several courts have found a duty to defend in situations where the administrative body is acting "in a judicial capacity." For example, in *Detrex Chemical Industries, Inc. v. Employers Insurance of Wausau*,<sup>76</sup> the court held that Employers had a defense obligation because an administrative board "acts in a judicial capacity when it hears evidence and witnesses, the parties are given an opportunity to brief and argue their versions of the facts and present arguments, and the parties are given an opportunity to seek court review of any adverse findings."<sup>77</sup> In environmental cases a number of courts have found that a letter from a federal agency can trigger a duty to defend.<sup>78</sup> These courts reason that "the administrative process is part of a 'litigious process' that triggers the obligation to defend."<sup>79</sup>

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before a plaintiff may sue in state or federal court. See, e.g., CAL. GOV'T CODE § 12965(b) (West 1992 & Supp. 1995); *Rojo v. Kliger*, 801 P.2d 373, 383-84 (Cal. 1990) (en banc); ILL. ANN. STAT. ch. 775, para. 5/8-111(A) (Smith-Hurd 1993); *Castaneda v. Illinois Human Rights Comm'n*, 547 N.E.2d 437, 439-40 (Ill. 1989).

74. 568 A.2d 1129, 1132-33 (Md. Ct. Spec. App. 1990).

75. 571 A.2d 969, 970-71 (N.J. Super. Ct. App. Div.), *cert. denied*, 584 A.2d 230 (N.J. 1990).

76. 681 F. Supp. 438, 454 (N.D. Ohio 1987), *aff'd. in relevant part on reconsideration*, 746 F. Supp. 1310, 1315 (N.D. Ohio 1990).

77. *Id.* (citing *University of Tenn. v. Elliot*, 478 U.S. 788 (1986)). See also *Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178, 1188 & n.7 (7th Cir. 1980) (A "compliance review" by the General Services Administration does not trigger a duty to defend, that "we leave for another day the question of whether the duty to defend . . . is necessarily confined to judicial proceedings."), *cert. denied*, 449 U.S. 1033 (1980).

78. See, e.g., *Aetna Casualty & Sur. Co. v. Pintlar Corp.*, 948 F.2d 1507 (9th Cir. 1991); *A.Y. McDonald Indus. Inc. v. Insurance Co. of N. Am.*, 475 N.W.2d 607, 628 (Iowa 1991); *Minnesota Mining & Mfg. Co. v. Travelers Indem. Co.*, 457 N.W.2d 175 (Minn. 1990). *But see*, *Lapham-Hickey Steel Corp. v. Protection Mut. Ins. Co.*, 655 N.E.2d 842 (Ill. 1995). See generally OSTRAGER & NEWMAN, *supra* note 6, § 10.04(c) (collecting cases).

79. *Avondale Indus. v. Travelers Indem. Co.*, 697 F. Supp. 1314, 1322 (S.D.N.Y. 1988), *aff'd*, 887 F.2d 1200 (2d Cir. 1989), *modified and reh'g denied*, 894 F.2d 498 (2d

### 3. Parol Evidence and Rules of Policy Construction

Different forums apply different choice of law rules to determine the governing of the parol evidence rule. Although the traditional view was that the parol evidence rule was an evidentiary matter controlled by the law of the forum,<sup>80</sup> more recent cases tend to view it as a substantive matter often determined by the law of the jurisdiction whose law controls policy interpretation.<sup>81</sup>

Depending on the matter at issue, it may or may not be in the interest of a policyholder or insurer to seek introduction of parol evidence. In some cases a policyholder or insurer may prefer to avoid introduction of parol evidence and seek summary judgment. This approach has the advantage of avoiding the time-consuming and expensive discovery and trials that often accompany parol evidence disputes on matters of policy interpretation.

One important factor in deciding whether to seek summary judgment on matters of policy construction is the extent to which a policyholder can rely on favorable rules of construction. Where a contract is ambiguous, the policyholder can, in some cases, rely on the principle that ambiguous policy provisions must be construed in its favor, and the burden is on the insurer to introduce extrinsic evidence to demonstrate that its interpretation of the policy is the only reasonable one.<sup>82</sup> Some courts have refused to apply the traditional rule of construing insurance policies against the insurer in cases that involve a sophisticated policyholder or a negotiated manuscript policy.<sup>83</sup>

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Cir. 1990), *cert. denied*, 496 U.S. 906 (1990), *partial final judgment entered*, No. 86 CIV. 9626, 1993 WL 427035 (S.D.N.Y. Oct. 15, 1993).

80. 16 AM. JUR. 2d *Conflict of Laws* § 132 (1979).

81. *E.g.*, *Transnor (Bermuda) Ltd. v. BP N. Am. Petroleum*, 736 F. Supp. 511, 519 n.10 (S.D.N.Y. 1990).

82. *See, e.g.*, *Sequoia Ins. Co. v. Royal Ins. Co. of Am.*, 971 F.2d 1385, 1390 (9th Cir. 1992) ("Where an ambiguity cannot be resolved by resort to extrinsic evidence we resolve ambiguities in insurance policy provisions in favor of the insured.") (applying California law); *Vargas v. Insurance Co. of N. Am.*, 651 F.2d 838, 840 (2d Cir. 1981) ("The insurer bears a heavy burden of proof, for it must 'establish that the words and expressions used [in the insurance policy] not only are susceptible of the construction sought by [the insurer] but that it is the only construction which may fairly be placed on them.'") (quoting *Filor Bullard & Smith v. Insurance Co. of N. Am.*, 605 F.2d 598, 602 (2d Cir. 1978), *cert. denied*, 440 U.S. 962 (1979)); *Springfield Fire & Casualty Co. v. Garner*, 627 N.E.2d 1147, 1153 (Ill. App. Ct. 1993) ("When a policy provision is ambiguous, all doubt must be resolved in favor of the insured."), *appeal denied*, 633 N.E.2d 15 (1994).

83. *E.g.*, *Eastern Assoc. Coal Corp. v. Aetna Casualty & Sur. Co.*, 632 F.2d 1068, 1075 (3d Cir. 1980), *cert. denied*, 451 U.S. 986 (1981).

#### 4. Can the Case Be Limited to the Duty to Defend?

Another issue that must be considered in determining whether a duty to defend exists under the law of a particular forum concerns the extent to which a coverage case can be limited to an insurer's defense obligations. This is an important tactical consideration.

Most coverage attorneys agree that a policyholder's strategic planning should give priority to winning the underlying lawsuit and avoiding liability altogether, rather than plotting to obtain coverage in the event liability is imposed upon it. A number of insurer coverage defenses, particularly the defense that there is no coverage because the damages at issue were intentional or "expected or intended," ally the insurer with the party suing the policyholder. It is obviously not in the interest of the insurer or the insured to have the insurer developing evidence that may be used against the insured in the underlying case. One approach to this situation is to attempt to deal with the defense obligation as a matter of summary judgment based on the policy and the underlying complaint and then to seek a stay of further proceedings pending resolution of the case for which coverage is sought.<sup>84</sup> As one court recently explained:

To the extent the declaratory judgment might resolve an issue adversely to the insured, it would be inherently unfair to force the insured to litigate against the insurance company; under those circumstances, rather than obtaining the benefit of the [insurer's] resources and expertise in defending against the plaintiff, those resources, for which the insured had bargained, would be turned against the insured and used to help establish his or her liability.<sup>85</sup>

Such motions for stay are more common where the insurer has commenced the case, but the policyholder can sometimes structure the situation by suing for defense and indemnity obligations in separate counts. The availability of a stay will normally depend on a

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84. See *Allstate Ins. Co. v. Harris*, 445 F. Supp. 847, 851 (N.D. Cal. 1978); A. WINDT, *INSURANCE CLAIMS AND DISPUTES* § 8.04 (2d ed. 1989) ("The majority of recent cases . . . have held that a declaratory judgment should not be entered if it depends on the resolution of factual disputes that are at issue in the underlying action.").

85. *Morris v. Farmers Ins. Exch.*, 771 P.2d 1206, 1211 (Wyo. 1989) (citation omitted). See also *Hartford Ins. Group v. District Court*, 625 P.2d 1013, 1017 (Colo. 1981) (en banc); *Vanguard Ins. Co. v. Townsend*, 544 So. 2d 1153, 1155 (Fla. Dist. Ct. App. 1989) ("[C]ourts will not permit the insurance company to preempt the resolution of fact issues necessarily involved in both suits."), *overruled by*, 595 So. 2d 1005 (Fla. 1992); *State Auto. & Casualty Underwriters v. Gardiner*, 370 P.2d 91, 93 (Kan. 1962).

combination of the substantive law of the controlling jurisdiction with respect to the duty to defend and duty to indemnify and the procedural law of the forum state as to declaratory judgment actions, bifurcation of trials, and stays of proceedings.

### 5. Allocation of Defense Costs

Different jurisdictions apply different legal principles in determining how defense costs should be paid where multiple insurers have an obligation to pay. Some courts allow the insured to pick any insurer with a defense obligation reasoning that each insurer has an independent obligation to defend.<sup>86</sup> Other courts allocate defense responsibilities among responsible insurers and may allocate some of the defense obligation to the insured if there are periods of time it does not have collectible coverage.<sup>87</sup>

### 6. Unexpected and Unintended: Disparate Treatment vs. Disparate Impact

Discrimination cases tend to fall into two discrete categories: disparate treatment cases and disparate impact cases. Disparate treatment cases deal with situations in which different groups have been intentionally treated differently. Disparate impact cases, on the other hand, tend to involve situations in which otherwise neutral conduct has had a disparate impact on different groups.

Claims of disparate impact are, in general, likely to more clearly trigger a duty to indemnify than claims of disparate treatment. Because they usually involve unintentional conduct, disparate impact cases may involve damages that are "unexpected and unintended," so that coverage is not precluded by policy provisions that exclude coverage for intentional acts or for injuries expected or intended by the insured.<sup>88</sup> Disparate treatment cases, in contrast, often involve *intentional* discrimination, which may be "expected or

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86. See, e.g., Nordby v. Atlantic Mut. Ins. Co., 329 N.W.2d 820, 824 (Minn. 1983).

87. See Insurance Co. of N. Am. v. Forty-Eight Insulations, Inc., 657 F.2d 814, 816 (6th Cir.), cert. denied, 454 U.S. 1109 (1981).

88. See, e.g., Solo Cup Co. v. Federal Ins. Co., 619 F.2d 1178, 1181, 1184-85 (7th Cir.) (finding coverage for unintentional disparate impact discrimination under an "umbrella excess liability policy" issued in 1974), cert. denied, 449 U.S. 1033 (1980); Union Camp Corp. v. Continental Casualty Co., 452 F. Supp. 565, 568 (S.D. Ga. 1978) (insurance against losses resulting from discriminatory employment practices not void as against public policy); School Dist. No. 1 v. Mission Ins. Co., 650 P.2d 929, 935-36 (Or. Ct. App. 1982) (suggesting that unintentional disparate impact discrimination is covered by "errors and omissions" provision in CGL policy), review denied, 662 P.2d 725 (Or. 1983).

intended” and are therefore not normally a covered occurrence.<sup>89</sup>

This distinction highlights the importance of the constructions of policy provisions that restrict coverage to damage “neither expected nor intended by the insured” utilized by various jurisdictions. In most courts, the focus of these kinds of provisions is on whether the insured expected or intended some damage.<sup>90</sup> Other courts, however, may focus on whether the act that caused the injury was intended.<sup>91</sup> Where this is the case, an insurer could argue that the corporate establishment of a policy constitutes intentional conduct, not subject to coverage, even though there was no intent to injure anyone at all.<sup>92</sup>

### 7. Intentional Acts Exclusion: Constructive vs. Actual Wrongful Discharge

Policy exclusions for intentional acts may be extremely important in wrongful discharge cases. An insurer may deny coverage for wrongful discharge on the theory that “the *actual* discharge of an employee cannot be an accidental event and . . . there is no coverage for such discharge where the policy contains an exclusion for intentional acts.”<sup>93</sup> Thus, where plaintiffs allege wrongful discharge, some courts hold that insurers need not even defend the claim.<sup>94</sup>

A claim for *constructive* wrongful discharge is more likely to be covered by insurance policies as an accidental occurrence. For example, in *Vienna Family Medical Associates, Inc. v. Allstate Insurance Co.*,<sup>95</sup> the insured was sued for “[creating] a hostile work

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89. See, e.g., *Union Camp Corp.*, 452 F. Supp. at 567-68 (finding coverage for unintentional discrimination but not for intentional discrimination); *School Dist. No. 1*, 650 P.2d at 935-36 (same).

90. E.g., *Allstate Ins. Co. v. Kim W.*, 206 Cal. Rptr. 609, 612-13 (Cal. Ct. App. 1984); *American Family Mut. Ins. Co. v. Johnson*, 816 P.2d 952, 954-55 (Colo. 1991) (en banc).

91. E.g., *Allstate Ins. Co. v. Salahutdin*, 815 F. Supp. 1309, 1312-13 (N.D. Cal. 1992).

92. See, e.g., *E-Z Loader Boat Trailers, Inc. v. Travelers Indem. Co.*, 726 P.2d 439, 442 (Wash. 1986) (en banc).

93. *St. Paul Mercury Ins. Co. v. Medical Lab. Network, Inc.*, 690 F. Supp. 901, 903 (C.D. Cal. 1988). See also *American Guar. & Liab. Ins. Co. v. Vista Medical Supply*, 699 F. Supp. 787, 789-90 (N.D. Cal. 1988).

94. *American Guarantee*, 699 F. Supp. at 789-90 (finding no duty to defend for wrongful discharge because the policy at issue did not cover “[p]urposeful acts”); *St. Paul Mercury Ins. Co. v. Ralee Eng’g Co.*, 804 F.2d 520, 521-22 (9th Cir. 1986) (holding no duty to defend existed where plaintiff alleged wrongful discharge and intentional infliction of emotional distress).

95. 872 F. Supp. 1509 (S.D.W. Va. 1995).



environment and constructively discharg[ing] [the plaintiff] from her employment with the intent to retaliate."<sup>96</sup> The court declared that the insurer must provide a defense and indemnification for all claims alleging negligent conduct.<sup>97</sup> Other courts have been more skeptical of claims alleging constructive discharge and have held that in some circumstances the employer can be presumed to have "intended" that the employee resign.<sup>98</sup>

## 8. Late Notice

Although we assume for purposes of this article that the policyholder has given prompt and appropriate notice, there are situations in which a carrier defense of late notice may be crucial to a coverage case. There are substantial variations in the law that various jurisdictions apply to late notice defenses. Jurisdictions are split as to whether an insurer is required to show prejudice to support a late notice defense.<sup>99</sup> Even in states that require insurers to show prejudice, there may be variations in the standard for showing prejudice.<sup>100</sup> In addition, different courts may afford varying degrees of significance to notice received by the insurer from third parties

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96. *Id.* at 1512.

97. *Id.* at 1513.

98. *E.g.*, *St. Paul Mercury Ins. Co. v. Medical Lab. Network, Inc.*, 690 F. Supp. 901, 903-04 (C.D. Cal. 1988) (holding that because the insured had "knowledge of the intolerable actions and conditions and of their impact on the employee," it was presumed that the employer "intended" that the employee resign). See also the recent decision of an Illinois appeals court in *Society of Mt. Carmel v. National Ben Franklin Insurance Co.*, 643 N.E.2d 1280 (Ill. App. Ct. 1994), in which the court held that mere allegations of negligence will not automatically trigger a duty to defend:

Here [the underlying plaintiff's] complaint seeks recovery for negligent infliction of emotional distress. However, the complaint sets forth no negligent acts or any facts from which such negligence can be inferred. Rather, the acts upon which that count is based are the very same acts which underlie every other count of the [plaintiff's] complaint, the intentional discharge. Thus, the count alleging negligent infliction of emotional distress does not constitute an occurrence or accident under the terms of the comprehensive general liability policy . . . .

*Id.* at 1289.

99. *E.g.*, *Collin v. American Empire Ins. Co.*, 26 Cal. Rptr. 2d 391, 409 (Cal. Ct. App. 1994) ("Under California law, an insured's breach of these conditions will relieve the insurer of liability if it is actually prejudiced by the late notice."); *but see* *Hoechst Celanese Corp. v. National Union Fire Ins. Co.*, No. CIV A. 89C-SE-35, 1994 WL 721639, at \*3 (Del. Super. Ct. 1994) ("New York law, however, does not require a showing of prejudice in conjunction with proof of late notice.").

100. *Compare* *Baugh Constr. Co. v. Mission Ins. Co.*, 836 F.2d 1164, 1174 (9th Cir. 1988) (Washington law) *with* *Aetna Casualty & Sur. Co. v. Murphy*, 538 A.2d 219, 223-24 (Conn. 1988).

other than the policyholder.<sup>101</sup>

### 9. Trigger and Allocation

In situations in which a course of conduct on which liability is based spans an extended period of time, there are always significant coverage issues about which policies are triggered and that should respond. Discrimination and wrongful discharge claims are no exception.

Practitioners familiar with the massive cases concerning coverage for asbestos injuries and environmental risks will already be familiar with the concepts of injury in fact, manifestation, and double, triple, and continuous trigger.<sup>102</sup> In the employment context, a pattern or practice of discrimination that continues for more than one policy year may trigger multiple policies. However, some cases have held that the policies are triggered when the injury manifests itself.<sup>103</sup>

### 10. Discovery

Discovery in a significant coverage action can be contentious. In addition to requests for claims and underwriting files relating to the policy and claim at issue, the insured may seek sensitive insurer documents concerning drafting history, correspondence with reinsurers, and, in some cases, information about other claims and loss reserves. The insurers, on the other hand, may seek confidential policyholder documents, prepared in the underlying action or for other purposes, that may be privileged.

#### *a. Drafting history and documents related to policy construction*

Where the interpretation of an insurance policy is at issue, the insured may seek documents and other discovery pertaining to the drafting history of relevant policy provisions.<sup>104</sup> This may include attempts to discover documents from files of the Insurance Service Office or similar organizations whose forms may have been utilized

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101. *Compare* American Home Assurance Co. v. Republic Ins. Co., 984 F.2d 76, 78 (2d Cir.), *cert. denied*, 113 S. Ct. 2964 (1993) *with* Mahone v. State Farm Mut. Auto. Ins. Co., 373 S.E.2d 809, 811 (Ga. Ct. App. 1988).

102. For a discussion of various trigger theories, *see* Armstrong World Indus., Inc. v. Aetna Casualty & Sur. Co., 26 Cal. Rptr. 2d 35, 49-52 (Cal. Ct. App. 1993).

103. *See supra* note 7.

104. *E.g.*, Champion Int'l Corp. v. Liberty Mut. Ins. Co., 129 F.R.D. 63, 67 (S.D.N.Y. 1990); Heyman Assocs. No. 1 v. Insurance Co. of Pa., 653 A.2d 122, 128 n.10 (Conn. 1995).

in preparation of the relevant provisions.<sup>105</sup>

The insured may also attempt to gain access to files concerning other policyholders who may have had similar coverage disputes. Evidence of positions that carriers have taken with other insureds, with respect to similar or identical policy language, may be discoverable on the theory that it is relevant to contract interpretation.<sup>106</sup>

In significant part, the discoverability of these kinds of materials will turn on whether parol evidence is admissible with respect to policy interpretations in a case in a particular jurisdiction.<sup>107</sup> As noted earlier, different forums may apply different choice of law principles to this determination.<sup>108</sup> A decision as to whether to expend the time and expense of substantial discovery into parol evidence and drafting history may have important tactical implications.

*b. Reinsurance materials*

One area of discovery that carriers often resist involves correspondence and communications with reinsurers. Reinsurance is essentially the insurance of insurers.<sup>109</sup> In many cases, a particular insurance policy will be reinsured, either individually or as part of a group of policies, by one or more reinsurers, and the insurance company will report claims and other relevant information to the reinsurer.<sup>110</sup> In general, insurers and reinsurers vigorously contest the discovery of their reinsurance files and their communications with one another.<sup>111</sup> The theory is that the reinsurers have no obligations to the insured and that communications between the insurers and reinsurers are confidential communications that are often a

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105. *E.g.*, *Hoechst Celanese Corp. v. National Union Fire Ins. Co.*, 623 A.2d 1128 (Del. Super. Ct. 1992); *cf.* *Schering Corp. v. Home Ins. Co.*, 712 F.2d 4, 9 (2d Cir. 1983) (holding summary judgment was precluded where "[the defendant] submitted affidavits of the drafters of the industry-wide standardized CGL clause asserting an explication completely at variance from [the plaintiff's] construction of the contract").

106. *See, e.g.*, *Independent Petrochemical Corp. v. Aetna Casualty & Sur. Co.*, 117 F.R.D. 283, 286-87 (D.D.C. 1986); *National Union Fire Ins. Co. v. Stauffer Chem. Co.*, 558 A.2d 1091, 1093-96 (Del. Super. Ct. 1989).

107. *See Independent Petrochemical*, 117 F.R.D. at 287 n.3.

108. *Id.*

109. For a description of reinsurance and the reinsurance industry, see *Unigard Security Insurance Co. v. North River Insurance Co.*, 4 F.3d 1049, 1053-54 (2d Cir. 1993).

110. *Id.* at 1054.

111. *E.g.*, *Potomac Elec. Power Co. v. California Union Ins. Co.*, 136 F.R.D. 1, 2 (D.D.C. 1990).

part of a joint defense.<sup>112</sup>

In recent years, a number of courts have compelled discovery of reinsurance materials and communications.<sup>113</sup> Initially, they reason that reinsurance arrangements are subject to procedural rules that expressly permit discovery of insurance information.<sup>114</sup> Several courts have held that reinsurance information is discoverable pursuant to this provision.<sup>115</sup>

Courts have also tended to find that communications between the insurer and the reinsurer in the ordinary course of business, particularly where no lawyers are involved, are discoverable.<sup>116</sup> Because reinsurance files often contain information concerning an insurer's views on the underlying litigation, policy interpretation, and the availability of coverage, reinsurance files can be a fertile source of discovery for an insured.

*c. Insurer discovery: Will policyholder files lose applicable privileges?*

Insurers confronted with coverage litigation typically seek extensive discovery into the files of the insured concerning insurance, the original placement of the insurance and the underlying dispute. The scope of the insurer's investigation into the underlying dispute can be extremely broad and may extend to discovery of documents that are ordinarily privileged.

(1) Choice of law and issues of privilege

The issue of controlling law for disputes over policyholder assertions of privilege is far from settled. The federal courts and most states view the protection for work product and the rules on admissibility of subsequent remedial measures as procedural matters governed by the law of the forum.<sup>117</sup> On the other hand, the availability of privileges, like the attorney-client or self-evaluation privileges, sometimes may be viewed as a substantive matter that is

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112. See *National Union Fire Ins. Co. v. Stauffer Chem. Co.*, 558 A.2d 1091, 1096 (Del. Super. Ct. 1989).

113. *Id.*; *Allendale Mut. Ins. Co. v. Bull Data Sys., Inc.*, 152 F.R.D. 132 (N.D. Ill. 1993).

114. See, e.g., FED. R. CIV. P. 26(b)(2).

115. *National Union Fire Ins. Co. v. Continental Ill. Corp.*, 116 F.R.D. 78, 84 (N.D. Ill. 1987); *Stauffer Chem. Co.*, 558 A.2d at 1096.

116. E.g., *Allendale*, 152 F.R.D. at 137.

117. E.g., *Kelly v. Crown Equip. Co.*, 970 F.2d 1273, 1277 (3d Cir. 1992) (subsequent remedial measures); *Allstate Ins. Co. v. Madan*, No. CV 94-4414-JDG, 1995 WL 313729 at \*3 n.3 (C.D. Cal. 1995) (work product doctrine).

determined by an analysis of other choice of law principles.<sup>118</sup>

The determination of what law applies is necessarily complex in a coverage case, where privileged materials are often prepared in reliance on the law of the jurisdiction in which the lawsuit was pending or where the work was done and subsequently sought through discovery in a completely different forum. The situation is further complicated when an insurer seeks production of arguably privileged policyholder documents, and a court must decide whether any implied waiver is determined by the substantive law that controls the insurance contract, the law that controls the pending coverage action, or the substantive or procedural law that controlled the underlying case against the insured.

The confusion and complexity with these choice of law issues is so substantial that some lawyers proceed on the assumption that documents prepared in connection with litigation for which an insured may subsequently seek insurance coverage may be subject to discovery by the insurer. Right or wrong, this assumption dictates that defense counsel and policyholder employees should exercise unusual care in preparing documents concerning any matters for which coverage may be sought.

(2) The attorney-client privilege and the work product doctrine

A number of jurisdictions have required insureds to produce materials normally protected by the attorney-client privilege and the work product doctrine in coverage litigation with their insurers. One of the leading cases is the decision of the Illinois Supreme Court in *Waste Management, Inc. v. International Surplus Lines Insurance Co.*<sup>119</sup> In that case, the court held that these protections from discovery do not apply to material produced in underlying liability suits, on the theory that such material was prepared for the "mutual benefit" of insurer and insured, even if the insurer denies coverage and becomes the policyholder's adversary in a later coverage dispute.<sup>120</sup> Several courts have adopted, at least in part, the rule enunciated in *Waste Management*. Some of them base their decisions on the existence of a cooperation clause in the insurance contract.<sup>121</sup> Others rely on variations of the "at issue" doctrine,

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118. See FED. R. EVID. 501; RESTATEMENT (SECOND) CONFLICT OF LAWS § 139 (1971).

119. 579 N.E.2d 322 (Ill. 1991).

120. *Id.* at 328-29, 330-31.

121. See, e.g., *Union Carbide Corp. v. Employer's Commercial Union*, No. CV

under which documents may lose their privileged status if put directly into issue in a particular case.

Although *Waste Management* recognizes that documents related to insurance coverage and any coverage dispute do not lose their privileged status, many courts have rejected the rule and reasoning of *Waste Management* but uphold the attorney-client privilege and work product doctrine with respect to documents prepared in the underlying case for which coverage is sought.<sup>122</sup> The court in *Bituminous Casualty Corp. v. Tonka Corp.*<sup>123</sup> articulated in detail its reasons for rejecting the *Waste Management* rule:

To hold that an insurance policy creates a contractual waiver of the attorney-client privilege, even when the insurance company later sues the insured contending the insured's claim is not covered by the policy, would completely eviscerate the attorney-client privilege. Absent a showing that the parties intended the language of the cooperation clauses of the insurance policies at issue here to work a waiver of the attorney-client privilege, [this] court declines to follow the holding of *Waste Management* to find a contractual waiver of the privilege.<sup>124</sup>

The court also stated on similar grounds that it "finds unsound the Illinois Supreme Court's extension of the 'common interest' exception to the attorney-client privilege."<sup>125</sup>

### (3) The self-evaluation privilege

Some insureds have claimed that a different privilege, the "self-evaluation privilege," protects certain confidential information from discovery.<sup>126</sup> The judicially created "self-evaluation" or

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2595 (D. Colo. July 15, 1993); *EDO Corp. v. Newark Ins. Co.*, 145 F.R.D. 18, 23 (D. Conn. 1992); *CHI of Alaska, Inc. v. Employer's Reinsurance Corp.*, 844 P.2d 1113, 1128 (Alaska 1993); *Carrier Corp. v. Home Ins. Co.*, No. 35 23 83, 1992 WL 478585 (Conn. Super. Ct. Aug. 18, 1992).

122. See, e.g., *North River Ins. Co. v. Philadelphia Reinsurance Corp.*, 797 F. Supp. 363, 367 (D.N.J. 1992); *Remington Arms Co. v. Liberty Mut. Ins. Co.*, 142 F.R.D. 408, 418 (D. Del. 1992).

123. 140 F.R.D. 381, 386 (D. Minn. 1992).

124. *Id.*

125. *Id.* at 386-87; see also *Rockwell Int'l Corp. v. Superior Ct.*, 32 Cal. Rptr. 2d 153, 156-59 (Cal. Ct. App. 1994) ("We . . . refuse to adopt the rules announced by the Illinois Supreme Court in a similar case, *Waste Management.*"), *review denied*, 1994 Cal. LEXIS 5610 (Oct. 20, 1994) and cases cited therein.

126. For a description of the "self-critical" or "self-evaluation" privilege generally, see *Reichhold Chemicals, Inc. v. Textron, Inc.*, 157 F.R.D. 522, 524-27 (N.D. Fla. 1994) and cases cited therein. For an analysis of the self-evaluation privilege in the context of employment discrimination cases, see *Aramburu v. Boeing Co.*, 885 F. Supp. 1434, 1439 (D. Kan. 1995).

“self-critical” “privilege prevents disclosure of confidential, critical, evaluative [and] deliberative material whenever the public interest in confidentiality outweighs an individual’s need for full discovery.”<sup>127</sup> The self-evaluation privilege has not been adopted by all courts<sup>128</sup> and many of those who have adopted it have limited its application to subjective impressions and opinions, not objective facts.<sup>129</sup>

At least one court has stated that the self-evaluation privilege should not apply in coverage cases where the information sought to be protected relates to the insured’s state of mind at issue in the coverage case: “Without access to the documents which defendants seek to inspect, it would be virtually impossible for the insurance companies to determine whether or not to provide coverage. . . . Evidence necessary to the determination of whether the pollution was intentional and knowing cannot be shielded.”<sup>130</sup> Although it has not been applied in this context, insurers will almost certainly argue that the reasoning of *Waste Management* and its progeny should be applied to reach a similar result.

## 11. Public Policy and Punitive Damages

Some courts hold that even if an insurance policy otherwise provides coverage, intentional discrimination is uninsurable as a matter of public policy.<sup>131</sup> Indeed, in some states, such as California, statutes render insurance for certain types of intentional discrimination unenforceable as against public policy.<sup>132</sup> Application

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127. *CPC Int’l, Inc. v. Hartford Accident & Indem. Co.*, 620 A.2d 462, 464 (N.J. Super. Ct. Law Div. 1992).

128. *See, e.g., Wei v. Bodner*, 127 F.R.D. 91, 101 (D.N.J. 1989).

129. *See, e.g., Webb v. Westinghouse Elec. Corp.*, 81 F.R.D. 431, 434-35 (E.D. Pa. 1978); *Wylie v. Mills*, 478 A.2d 1273 (N.J. Super. Ct. Law Div. 1984) and cases cited therein.

130. *CPC*, 620 A.2d at 468 (citations omitted).

131. *See, e.g., Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178, 1187 (7th Cir. 1980) (suggesting that coverage for intentional discrimination is uninsurable as a matter of public policy), *cert. denied*, 449 U.S. 1033 (1980); *Legg Mason Wood Walker, Inc. v. Insurance Co. of N. Am.*, 23 Fair Empl. Prac. Cas. (BNA) 778 (1980) (same); *cf. Ranger Ins. Co. v. Bal Harbour Club, Inc.*, 549 So. 2d 1005, 1009 (Fla. 1989) (analogizing to Title VII, finding intentional discrimination not involving employment discrimination uninsurable as a matter of public policy). *But see School Dist. for Royal Oak v. Continental Casualty Co.*, 912 F.2d 844, 849 (6th Cir. 1990) (“Public policy normally favors enforcement of insurance contracts according to their terms . . . .”); *Independent Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co.*, 515 N.W.2d 576, 579-80 (Minn. 1994).

132. *E.g., CAL. INS. CODE* § 533 (West 1993); *Save Mart Supermarkets v. Underwriters at Lloyd’s London*, 843 F. Supp. 597 (N.D. Cal. 1994) (construing the California statute); *see also, e.g., New York Insurance Department Circular Letter No. 6, Insur-*

of public policy to prevent coverage that is otherwise available under the terms of a particular insurance policy gives rise to difficult conflict of law issues that are similar to those encountered in cases that consider the insurability of punitive damages.

Consider, for example, the situation where a lawsuit is brought in Illinois for coverage for discriminatory conduct at a factory in Texas. The policy was purchased in Illinois through an Illinois broker from an insurer located in California. The underlying lawsuit for discrimination was tried in Texas state court and resulted in a multi-million dollar judgment for compensatory and punitive damages against the policyholder. Texas public policy permits coverage for punitive damages,<sup>133</sup> Illinois public policy arguably does not,<sup>134</sup> and a California statute renders coverage for intentional discrimination unenforceable.<sup>135</sup> What law governs?

The question is admittedly difficult, and different courts are likely to reach different results. Initially, it should be recognized that different jurisdictions may control different issues within the same case.<sup>136</sup> Thus, even if the policy was delivered in Illinois, and Illinois law controlled policy construction issues, Illinois law may not control the application of public policy principles to determine whether insurance coverage for punitive damages is available in a particular case.

This issue was recently considered by the Illinois appellate court in *United States Gypsum Co. v. Admiral Insurance Co.*<sup>137</sup> The case involved an Illinois lawsuit concerning coverage for the \$300,000 portion of a settlement allocable to potential liability for punitive damages. The settled claim involved property and prop-

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ance Coverage for Discrimination Claims based upon Disparate Impact and Vicarious Liability (May 31, 1994), reprinted in Joseph P. Monteleone, *Recent Developments in Insurance for Employment Related Litigation*, Appendix C, in PRACTICING LAW INSTITUTE, *Employment Law Liability Claims: What You Need to Know About Insurance Coverage*, 716 PLI/Comm 176 (May 10, 1995) (Circular Letter of State of New York Insurance Department concluding that liability coverage for disparate treatment violates public policy, while coverage for disparate impact does not); MASS. GEN. L. ch. 175 § 47, cl. 6(b), construed in *Boston Hous. Auth. v. Atlanta Int'l Ins. Co.*, 781 F. Supp. 80, 83-84 (D. Mass. 1992).

133. See *American Home Assurance Co. v. Safeway Steel Prods. Co.*, 743 S.W.2d 693, 703-04 (Tex. Ct. App. 1987).

134. *Beaver v. Country Mut. Ins. Co.*, 420 N.E.2d 1058, 1061 (Ill. App. Ct. 1981) (Illinois may permit insurance for punitive damages based on vicarious liability). See *International Surplus Lines Ins. Co. v. Pioneer Life Ins. Co.*, 568 N.E.2d 9, 15 (Ill. App. Ct. 1990), appeal denied, 580 N.E.2d 116 (1991).

135. CAL. INS. CODE § 533 (West 1993).

136. E.g., RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188, 193 (1971).

137. 643 N.E.2d 1226 (Ill. App. Ct. 1994).



erty owners located in South Carolina. The insurers argued that this portion of the settlement was not covered because punitive damages are uninsurable under Illinois law.

The court rejected the insurers' argument. Beginning with the choice of law issues, it held that "[i]n the absence of a specific choice of law provision, the general choice of law rules of the forum state, Illinois, control."<sup>138</sup> Noting that Illinois applies the "most significant contacts" test to determine which forum's law applies,<sup>139</sup> the court concluded that South Carolina law should control the insurability of the potentially punitive portion of the underlying claim because the underlying case was filed in South Carolina, the underlying plaintiff lived there, and the underlying injury occurred there. According to the court, under these circumstances South Carolina "would have the greater interest in determining whether the insured should be able to recover costs relating to the potentially punitive portion of the settlement entered into in that underlying action."<sup>140</sup> The court found further support for its conclusion that South Carolina law should control in language contained in some of the policies that provided that punitive damages would be covered "where permitted by law."<sup>141</sup>

After determining that normal choice of law principles would require application of South Carolina law, the court considered the issue of whether an Illinois court's application of South Carolina law, which permits insurance coverage for punitive damages, would violate Illinois public policy, which may not permit such coverage.

The court concluded that this application was not a problem in the context of the settlement:

[W]e cannot say that the application of South Carolina law will have much of an effect on Illinois citizens or on Illinois' regulation of its insurers. Moreover . . . South Carolina has a significant interest in regulating the insurers who issue policies covering underlying claims which occur in that State, as well as punitive damages assessed in those actions.<sup>142</sup>

The court relied on this analysis to hold that there was coverage for the settlement even under those policies that did not contain a pro-

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138. *Id.* at 1250.

139. *But see* *Allen v. State Farm Mut. Auto. Ins. Co.*, 574 N.E.2d 55, 60-61 (Ill. App. Ct. 1991).

140. *Gypsum*, 643 N.E.2d at 1250.

141. *Id.* at 1251.

142. *Id.*

vision allowing coverage for punitive damages "where permitted by law."

The decision in *Gypsum* is consistent with a Texas appellate court decision that holds that Texas has a strong interest in applying its rule permitting insurance of punitive damages to verdicts entered by Texas juries, even where the policies at issue were negotiated, paid for, and delivered outside of Texas.<sup>143</sup> Given these precedents, it is likely that an Illinois court would permit coverage for punitive damages in our hypothetical case, if it was provided by an applicable insurance policy.

This leaves the question of the California policy against coverage for intentional discrimination. This choice of law analysis should be similar to the analysis concerning punitive damages. The point, of course, is that these public policy issues can be extremely important and must be carefully considered in deciding where to file suit.<sup>144</sup>

## 12. Attorneys' Fees in Coverage Cases

The law varies as to whether a policyholder's right to attorneys' fees in a coverage case is a procedural matter controlled by the law of the forum or a substantive matter controlled by other conflict of law principles.<sup>145</sup> Most jurisdictions follow the general rule that insurance coverage disputes are no different from other breach of contract cases so that no attorneys' fees are available to either party in the absence of a contractual agreement or controlling statute.<sup>146</sup> Some states, however, have statutes that permit policyholder recoveries of reasonable attorneys' fees under certain circumstances.<sup>147</sup> In addition, there are some jurisdictions in which a policyholder "who is compelled to assume the burden of legal action to obtain

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143. *American Home Assurance Co. v. Safeway Steel Prod. Co.*, 743 S.W.2d 693 (Tex. Ct. App. 1987), *reh'g denied*, (1988).

144. *See Mencor Enters., Inc. v. Hets Equities Corp.*, 235 Cal. Rptr. 464, 466 (Cal. Ct. App. 1987) (California courts will apply California law if applying the law of other jurisdictions would violate strong California public policy).

145. *See, e.g., El Paso Natural Gas Co. v. Amoco Prod. Co.*, No. CIV. A. 12083, 1994 WL 728816, at \*4-\*5 (Del. Ch. Dec. 16, 1994) (attorneys' fees are substantive in nature when prescribed by statute); *Du-Wel Prods., Inc. v. United States Fire Ins. Co.*, 565 A.2d 1113, 1120 (N.J. Super. Ct. App. Div. 1989) (attorneys' fees are procedural in nature), *cert. denied*, 583 A.2d 316 (N.J. 1990).

146. *See, e.g., Kremers-Urban Co. v. American Employers Ins. Co.*, 351 N.W.2d 156, 167-69 (Wis. 1984) (refusing to depart from American rule that parties pay their own attorneys' fees absent a contractual or statutory provision to the contrary).

147. *See, e.g., ME. REV. STAT. ANN. tit. 24-A, § 2436-A* (West 1994). *See also infra* notes 149-58 and accompanying text.

the benefit of its insurance contract is entitled to attorney fees' whether or not the insurance policy contains a provision for such fees."<sup>148</sup> Obviously, the availability of attorneys' fees is an important bargaining point and financial issue that deserves consideration in any coverage case.

### 13. Consequential Damages, Special Remedies, Bad Faith Actions, and Unfair Trade Practice Statutes

Suits for insurance coverage normally are based on a breach of contract theory. Although contract actions may allow recovery of consequential damages, such as attorneys' fees expended on the coverage case,<sup>149</sup> they are not normally conducive to claims for punitive or enhanced damages.<sup>150</sup>

There are, however, some situations in which certain jurisdictions offer special remedies in coverage cases. For example, some states recognize special remedies for breach of a duty to defend or for a refusal to settle within policy limits. In *Fragman Construction Co. v. Preston Construction Co.*, for example, the court held that insurers that breach their duty to defend may be estopped from asserting coverage defenses such as late notice.<sup>151</sup> Similarly, as a corollary of traditional principles of consequential damages, most jurisdictions hold that an insurer that refuses to settle within policy limits may be held responsible for damages in excess of policy limits, in the event the case must be tried and liability is imposed as a result.<sup>152</sup>

In addition to these contract law theories, various states have recognized actions for bad faith that may result in punitive damages, particularly when the conduct of the insurer either is especially dishonest or affects the general public.<sup>153</sup> To the extent those

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148. *Public Util. Dist. No. 1 v. International Ins. Co.*, 881 P.2d 1020, 1034 (Wash. 1994) (en banc) (quoting *Olympic Steamship Co. v. Centennial Ins. Co.*, 811 P.2d 673, 682 (Wash. 1991)).

149. *See, e.g., Hegler v. Gulf Ins. Co.*, 243 S.E.2d 443 (S.C. 1978).

150. *See, e.g., DiBlasi v. Aetna Life & Casualty Ins. Co.*, 542 N.Y.S.2d 187, 192 (N.Y. App. Div. 1989) (no punitive damages even if breach of contract was wilful and without justification).

151. 274 N.E.2d 614, 616 (Ill. App. Ct. 1971) ("If potential coverage was present, Aetna breached its duty to defend and is estopped from raising any exclusionary coverage defenses . . .").

152. *See, e.g., Walbrook Ins. Co. Ltd. v. Liberty Mut. Ins. Co.*, 7 Cal. Rptr. 2d 513, 517 (Cal. Ct. App. 1992).

153. *See, e.g., DiBlasi*, 542 N.Y.S.2d at 192 (high degree of dishonesty or moral turpitude implies criminal indifference to civil obligations); *Samovar of Russia Jewelry*

actions sound in tort rather than in contract,<sup>154</sup> they are often controlled by the law of the jurisdiction where the wrong occurred.<sup>155</sup> Tort law choice of law principles may yield a different controlling law than application of the choice of law principles applicable to contract cases.

In addition to bad faith cases, many jurisdictions have statutory provisions that provide special statutory causes of action and remedies for insurer failures to honor insurance contracts.<sup>156</sup> In most cases, the statute itself sets forth the situations in which it will be applicable.<sup>157</sup> The Maine statute governing unfair claims practices, for example, applies on its face only to certain misrepresentations, failures to acknowledge and review claims within a reasonable time following written notice of a claim, threats to appeal arbitration awards solely to compel lesser settlements, or failures to affirm coverage, reserve appropriate defenses, or deny coverage within a reasonable time after receiving proof of loss forms.<sup>158</sup>

An attorney for a client that has been denied insurance coverage should carefully consider the extent to which consequential damages, attorneys' fees or multiple or enhanced damages may be available to his client under the law of potentially available jurisdictions.

## V. WHEN CAN YOU SUE?

In some cases, where an insured has an indemnity policy and has paid out defense costs or an adverse judgment or settlement, there is little question of the policyholder's right to sue for recovery. The analysis may be more difficult where an insurer is acting under a reservation of rights, and the insured is not yet in a position to make a demand for payment.

The traditional rule in federal court and in most state courts is that there must be an actual controversy to support a declaratory judgment action.<sup>159</sup> For this reason, the courts, in general, will not

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*Antique Corp. v. Generali*, 476 N.Y.S.2d 869, 873 (N.Y. App. Div. 1984) ("fraudulent, criminal or dishonest acts by the insurer concerning or affecting the general public").

154. See, e.g., *Judge Trucking Co. v. Estate of Cooper*, CIV. A. Nos. 92C-03-041, 93C-04-023, 93C-07-025, 1994 WL 680029, at \*3-\*4 (Del. Super. Ct. Sept. 19, 1994).

155. *Id.*

156. See, e.g., GA. CODE ANN. § 33-4-6 (1992 & Supp. 1995); ME. REV. STAT. ANN. tit. 24-A, § 2436-A (West 1994).

157. See, e.g., GA. CODE ANN. § 33-4-6 (1992 & Supp. 1995); ME. REV. STAT. ANN. tit. 24-A, § 2436-A (West 1994).

158. See, e.g., ME. REV. STAT. ANN. tit. 24-A, § 2436-A (West 1994).

159. E.g., *Nautilus Ins. Co. v. Winchester Homes, Inc.*, 15 F.3d 371, 375 (4th Cir.

permit an insurer to file a declaratory judgment action where the insurer has made no clear demand for coverage. As the court explained in *Atlanta International Insurance Co. v. Atchison, Topeka & Santa Fe Railway. Co.*,<sup>160</sup>

[I]n cases where . . . all determinative facts giving rise to the potential policy coverage dispute have occurred prior to the initial demand upon the insurance company, no actual controversy arises among the parties until such time as the issuing company is called upon to either pay or defend a claim on behalf of its insured under the terms of the policy in question.<sup>161</sup>

Most courts give strong deference to the first forum to assume jurisdiction over a case.<sup>162</sup> Because the choice of forum also controls choice of law and may be outcome determinative, the decision of when a decision is sufficiently ripe to support a lawsuit requires careful consideration and analysis.

## VI. CONCLUSION

Suits for insurance coverage present wide variations in degrees of complexity. Because of the diverse principles that govern critical legal issues, forum selection may be particularly crucial. The complexity of forum selection in a coverage case is often compounded by issues of jurisdiction and venue and variations in the choice of law principles employed by various courts.

As a result, like any significant commercial litigation, such cases require careful planning and analysis. The failure to consider carefully where suit can be brought and the likely course of events in a particular forum can lead to unanticipated outcomes and unfortunate, unforeseen results.

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1994); *City of Elgin v. County of Cook*, 629 N.E.2d 86, 94 (Ill. App. Ct. 1993), *aff'd in part and rev'd in part*, 1995 WL 646541 (Ill. Nov. 2, 1995).

160. 938 F.2d 81 (7th Cir. 1991) (applying Illinois law).

161. *Id.* at 83 (quoting *Gibraltar Ins. Co. v. Varkalis*, 263 N.E.2d 823, 826 (Ill. 1970)).

162. *E.g.*, *Admiral Ins. Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 848 S.W.2d 251, 255 (Tex. App. 1993), *reh'g overruled* (1993), *error denied* (1994).