Key Issues in Hawai'i Insurance Law Answered by the Moon Court

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I. INTRODUCTION[1]

In this article, attorneys with Hawai'i practices principally focused on insurance law comment on some of the major cases during the two decades when Chief Justice Moon led the court.[2] Chief Justice Moon's Supreme Court resolved several fundamental questions about insurance,[3] and its contributions will have an enduring impact on Hawai'i insurance law.

Although the cases discussed are considered important in Hawai'i, many of the legal questions that the court addressed had already been decided in other jurisdictions, so the court broke little new ground. In most instances, the court adopted a moderately pro-insured position, often specifically rejecting more liberal or conservative positions.

Indicative of that moderate trend is the court's approach to the reasonable expectations doctrine. Heralded forty years ago as an insurance doctrine that might correct the imbalance of power between insured and insurer, Professor and Judge Robert E. Keeton first stated the principle: "[t]he objectively reasonable expectations of applicants and intended beneficiaries of the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."[4] Over the years, some

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[3] University of Hawai'i Law Review student notes on two important cases are extensive, scholarly, and thorough. *See* Lane Christine Boyarski, Note, The Best Place, Inc. v. Penn America Insurance Company: *Hawai'i Bad Faith Cause of Action for Insurer Misconduct*, 19 U. HAW. L. REV. 845 (1997); Allison M. Mizuo, Note, Finley v. Home Insurance Co.: *Hawaii's Answer to the Troubling Tripartite Problem*, 22 U. HAW. L. REV. 675 (2000).

[4] Robert E. Keeton, *Insurance Law Rights At Variance With Policy Provisions: Part One*, 83 HARV. L. REV. 961, 967 (1970). *See also* Robert E. Keeton, *Insurance Law Rights At Variance With Policy Provisions: Part Two*, 83 HARV. L. REV. 1281 (1970).

jurisdictions have squarely rejected it, others have used a strong substantive form of it that "privileges the Insured's reasonable expectations above the explicit language of the contract,"[5] and others have used a lesser form, regarding it merely as an interpretative tool when confronted with a contract ambiguity or some other justifying circumstances. In the 1980s, Hawai'i cited and invoked the doctrine, but it was unclear in what camp Hawai'i stood.[6] During the Moon years, the reasonable expectations doctrine continued to be invoked within a frequently recited catechism of insurance contract interpretation; however, the author's view is that Hawai'i's construction squarely places it in the "weak" form camp to date.[7]

Moderate, cautious, and mainstream best sums up the Moon Court's insurance cases. Cases involving alleged insurer misconduct reveal a persistent optimism that mechanisms within the existing tort and regulatory system will suffice to check abuse without judicial imposition of novel torts or punitive measures.

Looking forward, I question whether these middle ground choices will achieve optimal outcomes. Insurance is a complex product marketed by sophisticated and powerful corporations that sometimes wield power and influence more akin to governmental action than private endeavor. Insurance is

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[5] Dudi Schwartz, *Interpretation and Disclosure in Insurance Contracts*, 21 LOY. CONSUMER L. REV. 105, 128 (2008) (describing strong, weak, and intermediate approaches of the reasonable expectations rule).

[6] In analyzing Hawai'i opinions from the 1980s, Professor Roger Henderson wrote, "one must admit the possibility that the Hawai'i court views the doctrine more as a rule of construction and may not embrace its broader, substantive application." Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 831-32 (1990).

[7] The court typically recites the reasonable expectations doctrine as an interpretative tool together with the plain meaning doctrine and contra proferentum. For example:

> It is well settled in Hawai'i that the objectively reasonable expectations of policyholders and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations. These "reasonable expectations" are derived from the insurance policy itself, which is subject to the general rules of contract construction. This involves construing the policy according to the entirety of its terms and conditions, and the terms themselves should be interpreted according to their plain, ordinary, and accepted sense in common speech unless it appears from the policy that a different meaning was intended. Because insurance policies are contracts of adhesion and are premised on standard forms prepared by the insurer's attorneys, we have long subscribed to the principle that they must be construed liberally in favor of the insured and any ambiguities must be resolved against the insurer.

Del Monte Fresh Produce, Inc. v. Fireman's Fund Ins., 117 Haw. 357, 183 P.3d 734 (2007) (internal brackets, ellipses, quotation marks, and citations omitted).

vital to safeguarding the financial future of individuals and the nation; it is far more than a private contractual relationship between an insured and a business.[8]

Young v. Allstate Insurance Co.,[9] a 2008 case that broke no new ground but could have, compels the question whether the middle path was the right path. In *Young*, the court had the opportunity to recognize a novel cause of action by third parties against insurers. The court declined to do so, even on particularly compelling facts. In 1998, an Allstate insured fell asleep at the wheel of his car and rear-ended eighty-four-year-old Priscilla Young's 1984 Ford.[10] Young's car was totaled and Young suffered substantial injuries that limited her activities of daily living and caused depression.[11] Although Young was not Allstate's insured, Allstate began a campaign to induce Young to settle the suit for far less than her actual damages.

The court described several of Allstate's alleged national practices, including its strategic direct contact with the victim designed to elicit the victim's trust that Allstate would deal fairly when its purposeful intention was not to be fair.[12] Among other things, Allstate's dealings with third-party victims encouraged them not to retain an attorney but to deal directly with Allstate.[13] At the same time, Allstate allegedly used a computerized valuation program that consistently undervalued claims.[14] Allstate, adhering to its claims model, rigidly made low settlement offers to victims, even against the advice of local counsel.[15]

Moreover, if accident victims hired attorneys to press their claims, Allstate's litigation stance was deliberately tyrannical.

> If a settlement offer were not accepted or the claimant hired an attorney, Allstate would fully litigate virtually every claim, irrespective of its insured's liability or

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[8] In a series of compelling articles, Professor Jeffrey Stempel demonstrates that courts should not merely view the insurance policy through the lens of contract law. He explains, "In addition to functioning as contracts, products, and statutes, insurance policies exist as social institutions or social instruments that serve important, particularized functions in modern society—often acting as adjunct arms of governance and reflecting social and commercial norms." Jeffrey Stempel, *Insurance as a Social Instrument and Social Institution*, 51 WM. & MARY L. REV. 1489, 1492 (2010). *See also* Jeffrey W. Stempel, *The Insurance Policy as Statute*, 41 MCGEORGE L. REV. 203 (2010) [hereinafter Stempel, *Insurance Policy as Statute*] (discussing the statute-like qualities of insurance policies, justifying and implicating a statutory interpretation approach); Jeffrey W. Stempel, *The Insurance Policy as Thing*, 44 TORT & TRIAL INS. PRAC. L.J. 813 (2009) (discussing "product-like" aspects of an insurance policy).

[9] 119 Haw. 403, 198 P.3d 666 (2008).

[10] *Id.* at 408, 198 P.3d at 671.

[11] *Id.*

[12] *Id.* at 406-08, 198 P.3d at 669-71.

[13] *Id.* at 408, 198 P.3d at 671.

[14] *Id.* at 407, 198 P.3d at 670.

[15] *Id.* at 408, 198 P.3d at 671.

> the real physical harm and value of the injuries suffered by the claimant. Allstate thereby sought to subject claimants to unnecessary and oppressive litigation and expenses, or, in other words, "scorched-earth litigation tactics." Allstate intended to force claimants and their attorneys through arbitration and trial unnecessarily. For example, if a non-binding arbitration award were anything more than nominal, Allstate's practice was to appeal the award. The insurer employed these tactics to discourage claimants from pursuing injury claims. Allstate also sought to discourage attorneys from representing claimants by creating so much work and expense that they could not afford to advocate for a client with minor, moderate, or sometimes even serious injuries.[16]

In the underlying accident case, Young eventually did hire an attorney and secured a nearly $200,000 judgment by jury trial.[17] Allstate's best and final settlement offer never exceeded $5,300.[18]

Young filed suit against Allstate and its local attorney, claiming, among other things,[19] that Allstate's conduct amounted to a tort that the plaintiff cast as "malicious defense."[20] Justice Nakayama, writing the majority decision of a divided court, refused to recognize the new tort.[21] The court took a gladiator-like view of litigation; and in doing so, championed an insurer's right to vigorously defend itself. In distinguishing malicious defense from the tort of malicious prosecution, the majority reasoned that the initiation of a suit, and not conduct during a suit, gives rise to a claim of malicious prosecution.[22] Once haled into court, litigation is no-holds barred in the majority's view. "The tort of malicious prosecution acknowledges the special, particular harms that a defendant suffers when a lawsuit is maliciously initiated against it."[23] In rejecting the tort, the majority viewed the plaintiff (in this case Priscilla Young) as *choosing* to be a litigant and voluntary assuming the attendant risks that Allstate would relentlessly defend itself. The court expressed concern that recognition of the tort of malicious defense might inhibit a defendant's ability

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[16] *Id.* at 407, 198 P.3d at 670.

[17] *Id.* at 409, 198 P.3d at 672.

[18] *Id.*

[19] "Young asserted Defendants were liable for, among other things, (1) abuse of process, (2) malicious defense, and (3) IIED, and that Allstate had breached an assumed duty of good faith and fair dealing. For each claim, she requested compensatory and punitive damages." *Id.* at 410, 198 P.3d at 673. The Hawai'i Supreme Court remanded the case on the intentional infliction of emotional distress claim. *Id.* at 430, 198 P.3d at 693.

As a general rule, third party suits against insurers are not allowed. *See* Olokele Sugar Co. v. McCabe, Hamilton & Renny Co., 53 Haw. 69, 487 P.2d 769 (1971) (an injured person has no cause of action against a liability insurer in the absence of a contractual or statutory provision authorizing direct action).

[20] *Young*, 119 Haw. at 411, 198 P.3d at 674.

[21] *Id.* at 416-17, 198 P.3d at 679-80.

[22] *Id.*

[23] *Id.* at 418, 198 P.3d at 681.

to defend itself vigorously.[24] This view, however, ignores the fact that absent sanctions, an insurer benefits the less it pays and the longer it withholds paying valid claims. In fact, the legislature has defined unfair settlement practices to include "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear."[25]

Following a recurrent theme in its insurance cases,[26] the court declared that existing judicial and regulatory mechanisms were adequate to remedy insurer misconduct. It noted that the insurer and its attorney's conduct were sufficiently governed by existing court rules and statutes to check misconduct and tort laws to remedy it.[27] "In light of the plethora of remedies available to plaintiffs when defendants' litigation tactics are brought in bad faith, and because we should not chill the defendants' right "to conduct a vigorous defense," we decline to adopt the tort of malicious defense."[28] The court regarded a judge's inherent authority over the conduct of litigation to be sufficient to curb the abuses of insurers and their attorneys.[29] The court declined to join New Hampshire and become the second state to recognize the tort,[30] even though it could have limited its application to insurance as it had the tort of bad faith in *Best Place*.[31]

Young exposed a systematic insurance practice that makes one question whether any court can adequately protect consumers, let alone whether a

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[24] *Id.*

[25] HAW. REV. STAT. § 431:13-103(a)(11)(H) (2005).

[26] *See, e.g.*, Finley v. Home Ins. Co., 90 Haw. 25, 34, 975 P.2d 1145, 1154 (1998) (rejecting the need for *Cumis* counsel in Hawai'i and expressing the view that an attorney acting in accord with the Rules of Professional Responsibility can adequately safeguard insured from inappropriate insurer interference and that sufficient remedies exist to discourage misconduct); Sentinel Ins. Co. v. First Ins. Co., 76 Haw. 277, 875 P.2d 894 (1994) (rejecting the blanket rule that prohibits an insurer from litigating coverage following a breach of the duty to defend because other lesser remedies are adequate).

[27] The Supreme Court of Hawai'i explained:

> By rejecting the tort of malicious defense, we are by no means authorizing or condoning malicious action on the part of a defendant. In our view, however, such offenses are sufficiently deterred by Hawaii's rules and statutes that authorize the court to sanction the malicious defendant. Accordingly, the tort of malicious defense is unnecessary.

Young, 119 Haw. at 423, 198 P.3d at 686 (internal citations and footnotes omitted).

[28] *Id.* at 426, 198 P.3d at 689.

[29] *Id.* at 423, 198 P.3d at 686.

[30] *See* Aranson v. Schroeder, 671 A.2d 1023, 1028-29 (N.H. 1995); *see also* William Jordan, *Court Declines to Recognize Cause of Action for "Malicious Defense,"* 34 PROFESSIONAL LIABILITY REPORTER 6 (Feb. 2009) (identifying *Aranson* as the only case recognizing the tort of malicious defense).

[31] Best Place, Inc. v. Penn Am. Ins. Co., 82 Haw. 120, 132, 920 P.2d 334, 346 (1996). However, the court did allow Young to proceed against Allstate and its attorney on a theory of intentional infliction of emotional distress because of the extent of direct contact with her and the failed promises it made to her. *Young*, 119 Haw. at 429, 198 P.3d at 692.

moderate judicial approach is prudent. *Young* suggests that the gross imbalance of power between insurers and consumers warrants a strongly pro-insured judicial stance. After all, for every litigated case where insurers wrongfully delay payment, refuse to settle, decline an owed defense or coverage, or manipulate defense counsel, there are many more instances that do not even reach the court.

With *Young*, perhaps we should ask whether our so-called existing plethora of judicial and regulatory remedies can adequately protect consumers. As we reflect on the insurance law decisions over the last two decades, the question time will answer is whether, in choosing a middle ground, the court struck a balance that sufficiently protected insureds without creating the moral hazards that attend giving insureds more than they deserve under their agreements, or whether the court overestimated the resources of consumer insureds and victims and underestimated the power of insurers to work the system to their own advantage.

The insurance industry's ability to "overrule" courts also compels adopting a strong judicial preference for the insured's position. Through the Insurance Services Office (ISO), the insurance industry's organization that drafts standardized forms, insurers collectively respond to judicial decisions across the nation by re-drafting insurance policies.[32] Professor Jeffrey Stempel observed that "[i]nsurance policies act, to a degree, as private legislation by insurers controlling the shape and contour of coverage sold."[33] Stempel recounts the policy-drafting history of various coverage disputes such as Y2K, terrorism, and asbestos litigation, explaining the process that insurers collectively follow to cure what they fear are excessive exposures.[34] Stempel notes that policyholders have less power in the drafting process because "[i]nsurer groups or affiliated organizations (such as ISO) are not, of course, representative democracies. If insurers dislike judicial decisions they regard as excessively expanding coverage, their efforts to amend the policy language in question will not be impeded by any legislative caucus of policyholder representatives."[35] He notes that, while ISO and insurers, as a matter of sound business sense, include token representation of insureds and government regulators during drafting, "policyholders and the government are powerless to prevent insurers from revising policy language if the insurers determine this to be the best response to disfavored judicial precedent."[36] Thus, the industry has a power to affect the future in ways that policyholders and even the courts

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[32] Stempel, *Insurance Policy as Statute*, *supra* note 8, at 206.

[33] *Id.* at 215.

[34] *Id.* at 206.

[35] *Id.* at 248.

[36] *Id.*

cannot. The insurer's ability to respond to negative decisions justifies a heavy judicial thumb in favor of insureds on the scales of justice in these cases.

In the following sections, insurance practitioners discuss both the practical and policy implications of some of the more important insurance cases of the Moon years. The Moon Court took up a number of important and unresolved questions regarding coverage and defense and provided more certainty in this dynamic area of practice. In *Finley v. Home Insurance Co.*[37] and *Delmonte v. State Farm Fire and Casualty Co.*,[38] discussed in Part II of this article, the court settled a basic question about professional conduct that vexed Hawai'i for years: when an insurer selects and pays for counsel to defend an insured, does that counsel represent the insurer, the insured, or both? The court adopted the rule that insurance defense counsel represents only the insured, rejecting the dual representation model a majority of courts follow.

In *Sentinel Insurance Co., Ltd. v. First Insurance Co. of Hawai'i, Ltd.*[39] and *Dairy Road Partners v. Island Insurance Co., Ltd.*,[40] discussed in Part III, the court clarified just what "potential for coverage" means in establishing when and whether the liability insurer's duty to defend its insured is triggered.

In *Sentinel* and *Hawaiian Holiday Macadamia Nut Co. v. Industrial Indemnity Co.*,[41] discussed in Part IV, the court provided important guidance on the meaning of an "occurrence" under a CGL policy in Hawai'i.

In *Best Place, Inc. v. Penn America Insurance Co.*,[42] discussed in Part V of this article, the court finally recognized the tort of insurance bad faith, joining an overwhelming majority of states that had concluded that the unique status of insurers vis-à-vis their insureds justified potential exposure to tort liability for misconduct.

Part VI of this article addresses Moon Court decisions regarding Hawai'i's motor vehicle insurance law in three respects: decisions that defined—indeed broadened—the universe of who qualifies as an "insured" or "covered person"; decisions clarifying the number of "per person" or "each person" limits available to claimants who are not actually involved "in" motor vehicle accidents; and decisions guiding the settlement of underinsured motorists' insurance claims.

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[37] 90 Haw. 25, 975 P.2d 1145 (1998).
[38] 90 Haw. 39, 975 P.2d 1159 (1999).
[39] 76 Haw. 277, 875 P.2d 894 (1994).
[40] 92 Haw. 398, 992 P.2d 93 (2000).
[41] 76 Haw. 166, 872 P.2d 230 (1994).
[42] 82 Haw. 120, 920 P.2d 334 (1996).

II. ETHICAL ISSUES RELATING TO AN ATTORNEY'S REPRESENTATION OF THE INSURED[43]

Most liability insurance policies include duty to defend provisions, and typically those provisions provide the insurer with the right to select defense counsel and control the defense.[44] Customarily, the appointed defense counsel comes from an approved "panel" of attorneys. Attorneys on that panel will be familiar with the insurer's reporting requirements, defense practices and policies, and the insurer's billing guidelines and instructions. Frequently, the lawyer's relationship with the insurance company is a longstanding one; and he or she may have developed personal relationships and friendships with the claims professionals who work there. Implicitly, one of the lawyer's goals is to maintain that business relationship and, with it, the prospect of future case assignments. The lawyer's relationship with the insured, on the other hand, is more short-lived and is ordinarily confined to the defense of a single lawsuit.

When an insurer appoints counsel to defend its insured against a claim, who is the client in this situation? Is it the insured or the insurer? Or, as some jurisdictions hold, does the attorney engage in a dual representation, creating an attorney-client relationship with both?[45] When an insurer provides a defense under a reservation of rights,[46] as frequently happens, does this, by itself, create

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[43] The principal author of this section is Honolulu attorney Peter Olson of Cades Schutte LLP.

[44] Typical policy language expresses defense of the claim both as an insurer's right and duty, and the appointment of counsel as a right. For example:

> If a claim is made or a suit is brought against an *insured* for damages because of *bodily injury* or *property damage* caused by an *occurrence* to which this coverage applies, we will:
>
> 1. pay up to our limit of liability for the damages for which the *insured* is legally liable; and
> 2. provide a defense at our expense by counsel of our choice, even if the suit is groundless, false or fraudulent. We may investigate and settle any claim or suit that we decide is appropriate. Our duty to settle or defend ends when the amount we pay for damages resulting from the *occurrence* equals our limit of liability.

See Ins. Servs. Office, Homeowners 3 Special Form, HO 00 03 0491, *reprinted in* ALLIANCE OF AMERICAN INSURERS, THE INSURANCE PROFESSIONAL'S POLICY KIT: A COLLECTION OF SAMPLE INSURANCE FORMS 38 (2000) (emphases in original).

[45] For an excellent overview of the many legal and ethical issues relating to an attorney's representation of the insured, see Douglas R. Richmond, *Walking a Tightrope: The Tripartite Relationship between Insurer, Insured and Insurance Defense Counsel*, 73 NEB. L. REV. 265 (1994). *See also* Mizuo, *supra* note 3.

[46] Liability insurers commonly use reservation of rights letters to provide notice to insureds that even though the insurer is handling or defending a claim, some or all of the losses claimed by the plaintiff may not be covered by the policy and the insurer is preserving or "reserving" its right to deny coverage at a later date. Finley v. Home Ins. Co., 90 Haw. 25, 975 P.2d 1145 (1998); Delmonte v. State Farm Fire & Casualty Co., 90 Haw. 39, 975 P.2d 1159 (1999); AIG

a conflict of interest between the insurer and insured and allow the insured to select counsel of his or her own choice? The Moon Court provided some clarity to these vexing questions in a pair of decisions decided in late 1998 and early 1999: *Finley v. Home Insurance Co.*[47] and *Delmonte v. State Farm Fire & Casualty Co.*[48] *Finley* decided that an attorney representing an insured has only one client—the insured—even though the insurance company has selected the attorney and will pay for the legal services. With that decision, the court placed its trust in the integrity of Hawai'i's legal professional to place the interests of an insured client first, without regard to the lawyer's business relationship with the insurer. Weeks later, *Delmonte* delivered a warning to lawyers who do not scrupulously follow the mandates of *Finley*.

A. Finley

The *Finley* case addressed the issue of whether an insured defended by the insurer under a reservation of rights is entitled to reimbursement for the costs of independent counsel retained by the insured, sometimes referred to as "*Cumis*" counsel.[49] The plaintiffs, James and Vanida Finley, sued their employer for wrongful termination.[50] The employer carried a workers' compensation insurance policy through Hawaiian Insurance & Guaranty Co., Ltd., which had

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Haw. Ins. Co. v. Smith, 78 Haw. 174, 177, 891 P.2d 261, 264 (1995) (holding that an insurance company "may initially assume the unconditional defense of an insured while it performs its own reasonable investigation to determine whether coverage exists. . . . Once the insurer receives information concerning the possible absence of coverage, the insurer must promptly serve upon the insured a reservation of rights").

[47] 90 Haw. 25, 975 P.2d 1145.

[48] 90 Haw. 39, 975 P.2d 1159.

[49] Under the so-called *Cumis* doctrine, an insurer that defends the insured under a reservation of rights must retain and pay for independent counsel selected by the insured. San Diego Navy Fed. Credit Union v. Cumis Ins. Soc., Inc., 208 Cal. Rptr. 494 (App. 1984). Because it led to some abusive billing and defense practices by the insured's selected defense counsel, the *Cumis* doctrine came under much criticism from the insurance industry and was subsequently codified and modified by statute in California. *See* CAL. CIV. CODE § 2860 (West 2011). Under the statute, a conflict of interest exists—and the insured is entitled to the appointment of independent counsel—where the insurer's reservation of rights turns on an issue that can be controlled by defense counsel appointed by the insurer. *Id.* A conflict does not exist, however, merely because the insurer has reserved rights on an issue independent of those that will be litigated in the underlying case. In situations where the insured is entitled to the appointment of independent counsel, the insurer: is only required to pay the hourly rates customarily paid by the insurer for appointed defense counsel; may require that independent counsel selected by the insured possesses certain minimum qualifications; and may require that the attorney carries malpractice insurance. *Id.*

[50] *Finley*, 90 Haw. at 27, 975 P.2d at 1147.

become insolvent.[51] Pursuant to the Hawai'i insurance code,[52] the Hawai'i Insurance Guaranty Association (HIGA) assumed the handling of the claim. Prior to tendering the defense of the wrongful termination action to HIGA, however, the employer retained its own independent personal counsel to defend it in the action.[53] HIGA accepted the employer's tender under a reservation of rights letter but appointed its own panel counsel to defend the case.[54] The Finleys and the employer later entered into a stipulated judgment to settle the action. As part of the settlement, the employer assigned the stipulated judgment to the Finleys, including its claim against HIGA to recover the fees of its independent counsel, which HIGA had refused to pay.[55] The Finleys sued HIGA to recover those unreimbursed fees.[56]

The circuit court granted HIGA's motion for summary judgment and dismissed the Finleys' claim.[57] On appeal, however, the Hawai'i Intermediate Court of Appeals (ICA) vacated the circuit court's ruling and held:

> [W]here a conflict of interest arises between an insurer and an insured, because the insurer has reserved its right to assert noncoverage at a later date, the insurer is required to pay for independent counsel for the insured.
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> [A] reservation of rights can create a conflict of interest if 'the insurer's reservation of rights on the ground of noncoverage [is] based on the nature of the insured's conduct, which as developed at trial would affect the determination as to coverage.' When such a conflict of interest exists, the insurer is obligated to either obtain informed consent of the insured to the conflict of interest, or must pay the reasonable cost for hiring independent counsel by the insured.[58]

The Hawai'i Supreme Court granted certiorari to address two issues: (1) whether a conflict of interest arises when an insurer defends its insured under a reservation of rights based on the nature of the insured's conduct; and (2) if so, the appropriate remedy for such a conflict, whether actual or perceived.[59] The Hawai'i Supreme Court reversed the ICA's vacatur and affirmed the circuit court's grant of summary judgment in favor of HIGA.[60]

According to the Hawai'i Supreme Court, the fundamental flaw with the case law recognizing a right to independent counsel, as embraced by *Cumis* and its

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[51] *Id.*

[52] HAW. REV. STAT. § 431:16-108 (1993).

[53] *Finley*, 90 Haw. at 27, 975 P.2d at 1147.

[54] *Id.*

[55] *Id.* at 28, 975 P.2d at 1148.

[56] *Id.*

[57] *Id.*

[58] *Id.* at 29, 975 P.2d at 1149.

[59] *Id.*

[60] *Id.* at 39, 975 P.2d at 1159.

progeny, was that these cases implicitly assume that an insurer-appointed defense attorney is engaging in a dual representation, i.e., that both the insurer and the insured are the attorney's client.[61] The court, however, held that when an attorney is appointed by an insurer to represent its insured, the attorney's *sole* client is the insured. The court noted that this was "a matter of substantive state law" and looked to the Hawai'i Rules of Professional Conduct (HRPC) for guidance.[62] The better solution to the *Cumis* problem, the *Finley* court held, is not to engage in a conflict of interest analysis, but instead to rely upon the integrity of appointed defense counsel and his or her rigorous adherence to the rules of professional responsibility.[63] The court emphasized that an attorney who represents the insured must not allow the insurer to interfere with that attorney-client relationship.[64]

Thus, the court held an attorney has only one client and that client is the insured. Ethical obligations require the lawyer to place the insured's interest above the lawyer's own practical interests in preserving good relations with the insurer paying for the legal services.

The court recognized that under the insurance contract between the insurer and the insured, the insurer typically retains a contractual right to control the defense of the case.[65] Nonetheless, the insurer's desire to limit the costs of defending the insured "must yield to the attorney's professional judgment and his or her responsibility to provide competent, ethical representation to the insured."[66]

Although the insurer retains the contractual right to appoint defense counsel, *Finley* also holds that the insured retains the right to reject that appointment.[67]

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[61] *Id.* at 32, 975 P.2d at 1152.

[62] *Id.* at 32-33, 975 P.2d at 1152-53. The Hawai'i Supreme Court characterized this rule as the "modern view," *id.* at 33, 975 P.2d at 1153, but according to one legal treatise, the Hawai'i rule is apparently the minority rule. *See* 4 R. MALLEN & J. SMITH, LEGAL MALPRACTICE § 30:3 (2008) (footnote omitted).

[63] *Finley*, 90 Haw. at 31-32, 975 P.2d at 1151-52. As the court would outline in *Finley*, there are a host of ethical rules that provide guidance to appointed defense counsel. *See* HAW. R. PROF'L CONDUCT 1.2 (relating to scope of representation), 1.4 (relating to client communications), 1.5 (relating to fees), 1.6 (relating to confidentiality of information), 1.7 (relating to conflicts of interest), 1.8 (relating to prohibited transactions), and 5.4 (relating to professional independence). The *Finley* and *Delmonte* decisions subsequently generated two Hawai'i Disciplinary Board opinions that are relevant to the role of insurance defense counsel. *See* ODC Formal Op. 36 (1999) (addressing the scope of permissible disclosure of confidential client information); ODC Formal Op. 37 (1999) (relating to insurer-issued billing guidelines).

[64] *Id.* at 33, 975 P.2d at 1153.

[65] *Id.* at 31 n.9, 975 P.2d at 1151 n.9 (citation omitted).

[66] *Id.* at 34, 975 P.2d at 1154.

[67] *Id.* at 35, 975 P.2d at 1155. The *Finley* decision does not make clear whether the burden to inform the insured of his or her right to reject the insurer's appointment of defense counsel falls upon the insurer or rests with appointed defense counsel. Logically, it would seem that the

If the insured chooses to conduct the defense, then the insured is responsible for all defense costs. The insurer is still obligated to indemnify the insured as to any judgment or settlement falling within the scope of coverage under the policy.

To avoid any temptation defense counsel might have in caving in to the insurer's possible desire to minimize litigation costs and provide a "token" defense, or to possibly slant the defense toward a claim that is not covered by insurance, the court enumerated the alternate remedies available to the insured where appointed defense counsel does not meet his or her ethical duties:

> If the duties prescribed by the HRPC are not followed by retained counsel, various remedies exist to protect the insured. These remedies include: (1) an action against the attorney for professional malpractice; (2) an action against the insurer for bad faith conduct; and (3) estoppel of the insurer to deny indemnification.[68]

Finally, and of critical importance to a potential bad faith claim against the insurer, the court held that an "enhanced" standard of good faith is applicable where the insurer defends under a reservation of rights,[69] which the court explained as follows:

> First, the company must thoroughly investigate the cause of the insured's accident and the nature and severity of the plaintiff's injuries. Second, it must retain competent defense counsel for the insured. Both retained defense counsel and the insurer must understand that only the *insured* is the client. Third, the company has the responsibility for fully informing the insured not only of the reservation-of-rights defense itself, but of *all* developments relevant to his policy coverage and the progress of his lawsuit. Information regarding progress of the lawsuit includes disclosure of all settlement offers made by the company. Finally, an insurance company must refrain from engaging in any action which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk.[70]

B. Delmonte

In *Finley*, the Hawai'i Supreme Court set out a template for how defense counsel must defend the insured under a reservation of rights. In *Delmonte*, the

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burden should fall on the insurer; however, defense counsel may want to have that right made clear in the engagement letter with the insured.

[68] *Id.*

[69] *Id.* at 36, 975 P.2d at 1156 (adopting Tank v. State Farm Fire & Cas. Co., 715 P.2d 1133 (Wash. 1986)).

[70] *Id.* at 35-36, 975 P.2d at 1155-56 (emphases in original). The court observed that the responsibility to communicate settlement offers to the insured is a duty "more properly placed on the attorney, rather than the insurer." *Id.* at 36 n.12, 975 P.2d at 1156 n.12.

court addressed some pitfalls that might arise during the course of such representation.

The underlying dispute arose after the Delmontes sold their personal residence in Kailua under a DROA.[71] The buyers later sued the Delmontes for alleged misrepresentations made in connection with the sale.[72] The Delmontes retained counsel to defend the action.[73] Later, the Delmontes also tendered the defense of the action to their homeowner's insurer, State Farm, asserting that at least some claims were covered under their homeowner's policy.[74] Shortly before trial was to begin on the action brought by the buyers, State Farm appointed the law firm of Watanabe Ing & Kawashima (Watanabe) to represent the Delmontes under a written reservation of rights.[75]

Soon thereafter, Watanabe advised State Farm that, based upon its investigation and evaluation of the case, the Delmontes would likely be found liable and that there was a strong possibility that punitive damages would also be awarded against the Delmontes.[76] The buyers subsequently expressed a willingness to settle the case for approximately $120,000.[77] Mr. Delmonte indicated he was willing to pay two-thirds of the settlement if State Farm paid the other third.[78] State Farm, however, declined to contribute anything toward the settlement.[79] A few months later, Mr. Delmonte sent Watanabe a letter requesting that they perform certain work in connection with their defense of the case.[80] Watanabe consulted with State Farm about Mr. Delmonte's request, but State Farm declined to authorize the performance of the requested work.[81]

The case proceeded to a bench trial, at which the Delmontes were jointly represented by their personal counsel and Watanabe.[82] The trial judge awarded damages of almost $700,000 against the Delmontes, including punitive damages of $500,000.[83] Separate coverage counsel retained by State Farm advised it that it had a duty to appeal the judgment if "reasonable grounds"

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[71] Delmonte v. State Farm Fire & Cas. Co., 90 Haw. 39, 42, 975 P.2d 1159, 1162 (1999). A Deposit, Receipt, Offer and Acceptance (DROA) is a standard form contract for the sale of real property. *Id.*

[72] *Id.*

[73] *Id.* at 43, 975 P.2d at 1163.

[74] *Id.*

[75] *Id.* at 43-44, 975 P.2d at 1163-64.

[76] *Id.* at 44, 975 P.2d at 1164.

[77] *Id.*

[78] *Id.*

[79] *Id.*

[80] *Id.* at 45, 975 P.2d at 1165.

[81] *Id.*

[82] *Id.*

[83] *Id.*

existed for doing so.[84] State Farm then instructed Watanabe to prepare an opinion letter as to the merits of an appeal and a recommendation as to whether an appeal should be filed. However, State Farm also instructed Watanabe: "'[w]hen you prepare the [opinion] letter, please do not conduct any research and you need not detail every reason for or against your recommendation [as to whether to pursue an appeal].'"[85]

Watanabe filed a notice of appeal on behalf of the Delmontes, but then withdrew the appeal at State Farm's direction,[86] after having sent State Farm a letter advising that Watanabe did not see reasonable grounds for an appeal.[87] The Delmontes' personal attorney, on the other hand, wrote to State Farm and opined that there were reasonable grounds for appeal.[88]

Because the Delmontes were unable to afford a bond in order to stay the execution of the judgment, they settled with the buyers by paying the full amount of the judgment, plus interest—an amount totaling almost $765,000.[89] The Delmontes then sued both State Farm and Watanabe, alleging: (1) breach of contract by State Farm; (2) breach of the duty of good faith and fair dealing by State Farm; (3) that State Farm was liable for indemnification of the settlement; (4) that State Farm breached its duty to provide counsel of their choosing to the Delmontes and/or different counsel; (5) that State Farm was estopped from denying coverage; (6) that Watanabe's representation of the Delmontes was tainted by a conflict of interest between State Farm and the Delmontes; and (7) that Watanabe breached its fiduciary duties to the Delmontes.[90]

State Farm filed an answer and counterclaim, seeking a declaratory judgment that it owed no duty to defend or indemnify the Delmontes and otherwise had no liability for claims arising from the underlying lawsuit.[91]

The circuit court concluded that State Farm did not have a duty to prosecute an appeal from the underlying judgment because none of the findings in the judgment were covered claims under the applicable State Farm insurance policies.[92] The court also ruled that State Farm's insurance policies conferred upon State Farm the right to select counsel.[93] If Watanabe breached any duty

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[84] *Id.* State Farm's counsel advised State Farm to "seek a written opinion from defense counsel as to the merits of an appeal and rely upon that opinion in deciding whether to continue with the defense of the Delmontes." *Id.*

[85] *Id.* (emphasis omitted).

[86] *Id.* at 45-46, 975 P.2d at 1165-66.

[87] *Id.* at 46, 975 P.2d at 1166.

[88] *Id.* at 45, 975 P.2d at 1165.

[89] *Id.* at 46, 975 P.2d at 1166.

[90] *Id.*

[91] *Id.*

[92] *Id.*

[93] *Id.* at 46-47, 975 P.2d at 1166-67.

of care or loyalty to the Delmontes, their remedies rested in the malpractice action against Watanabe.[94] The Delmontes appealed.[95]

Just a few weeks after the *Finley* opinion came out, the Hawai'i Supreme Court issued its opinion in *Delmonte*, reaching several holdings.

First, the court ruled that the insurer's duty to defend includes a duty to appeal an adverse judgment against the insured where reasonable grounds exist for an appeal.[96] State Farm was required to consider *both* Watanabe's opinion that there were no reasonable grounds for an appeal, and the opinion expressed by the Delmontes' personal counsel that there were. The court noted that Watanabe's opinion was reached only after State Farm had given specific instructions to *not* conduct any legal research.[97] The court was troubled by the implication that State Farm might have influenced how the law firm represented the Delmontes.[98]

Second, State Farm's potential liability for bad faith could not be determined until there was a ruling on the malpractice claims against Watanabe.[99] Accordingly, the court reversed the summary judgment entered by the trial court in favor of State Farm as to the Delmontes' bad faith claim. The court explained:

> If Watanabe's conduct of the defense breached its duties toward its client, the Delmontes, then Watanabe may be liable for its breach. In addition, if such a breach was causally induced by State Farm's actions, then State Farm may potentially be liable for a breach of its duty of good faith and fair dealing.[100]

Finally, the court noted that "[t]he circuit court's determination that State Farm did not have a duty to defend the Delmontes d[id] *not* foreclose the possibility of a cognizable bad faith claim.[101]

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[94] *Id.* at 47, 975 P.2d at 1167.

[95] *Id.*

[96] *Id.* at 49, 975 P.2d at 1169.

[97] *Id.*

[98] *Id.*

[99] *Id.* at 54, 975 P.2d at 1174.

[100] *Id.*

[101] *Id.* at 55, 975 P.2d at 1175 (emphasis added). The Hawai'i Supreme Court also expressly disapproved of State Farm's conduct in contacting the attorney representing the plaintiffs in the underlying case and attempting to have him amend the complaint to remove the allegations that triggered potential coverage under State Farm's insurance policies. No damage flowed from this conduct, however, because the circuit denied the motion to amend, and State Farm continued to defend through trial. *Id.* at 55-56, 975 P.2d at 1175-76.

C. *The Significance of* Finley *and* Delmonte

In declining to hold that a defense provided by an insurer under a reservation of rights creates an irreconcilable conflict of interest between insurer and insured and thereby requires the appointment of independent counsel, the Moon Court squarely rejected the cynical view that appointed defense counsel lacks the inherent ability to place the insured's interests above the attorney's own interest in future employment by the insurer. As the court explained in *Finley*, "[w]hen retained counsel, experienced in the handling of insurance defense matters, is allowed full rein to exercise professional judgment, the interests of the insured will be adequately safeguarded."[102] In so holding, the Moon Court made a clear if unspoken statement about its trust and confidence in the integrity and ethics of the Hawai'i bar in general, the insurance defense bar in particular, and provided some needed clarity to an area of the law that was not without some confusion.

If *Finley* provided a legal framework for how appointed defense counsel should represent the insured, *Delmonte* may be viewed as something of a cautionary tale about the pitfalls that may result when defense counsel succumbs to the temptation to subordinate the insured's interests to those of the insurer. For attorneys who practice in this area, both *Finley* and *Delmonte* are fruitful reading and hold some very important lessons.

III. DEFINING THE DUTY TO DEFEND[103]

During Chief Justice Moon's tenure, the Hawai'i Supreme Court more fully developed the contours of the liability insurer's duty to defend. In two key cases, the court established that an insurer's obligation to defend exists where policy language suggests *any* possibility of coverage based upon the allegations in the underlying case. In assessing whether there is any possibility of coverage, the court struck a moderate position, neither as expansive in favor of insureds nor as narrow in favor of insurers as other jurisdictions have constructed the duty to defend.

Under a commercial general liability (CGL)[104] policy, defense of the insured is regarded as both an insurer's right and a duty. The policy provides that an insurer must defend a claim against an insured and pay claims as follows:

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[102] Finley v. Home Ins. Co., 90 Haw. 25, 34, 975 P.2d 1145, 1154 (1998).

[103] The principal authors of this section were Honolulu attorneys Tred Eyerly of Damon Key Leong Kupchak Hastert and Alan Van Etten of Deeley King Pang & Van Etten.

[104] A CGL policy was formerly known as a "Comprehensive General Liability" policy. In 1986, the industry changed the name to "Commercial General Liability" policy to avoid its title implying a broader scope of coverage than the policy provided. *See* ROBERT H. JERRY & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 517 (2007).

> [The insurer] will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies, caused by an occurrence and [*the insurer*] *shall have the right and duty to defend any suit against the insured seeking damages* on account of such bodily injury or property damage, even if the allegations are groundless, false or fraudulent . . . .[105]

The Moon Court considered when the insurer's duty to defend may be triggered based upon the nature of the factual and legal allegations in the underlying tort claim, as well as other circumstances that become evident during the course of the investigation of that claim.[106]

A. Triggering the Insurer's Duty to Defend

Sentinel Insurance Co. v. First Insurance Co. of Hawai'i considered both defense and indemnity obligations of multiple insurers issuing policies covering periods where continuing bodily injury or property damage occurs.[107] Authored by Chief Justice Moon, *Sentinel* also established a duty to defend where legal uncertainty exists as to whether allegations in the underlying complaint are potentially covered by the policy.[108]

In *Sentinel*, an apartment owners' association sued an insured contractor and developer, Honofed, alleging that defective design, construction, and materials caused water infiltration and property damage to a building project completed in April 1981.[109] Notably, the parties disagreed as to when the water infiltration and property damage began and how long it continued.[110]

Honofed was continuously insured under annual CGL policies alternately issued by Sentinel and First Insurance from April 1981 to April 1988. When the property owners filed suit, Honofed only tendered its defense to Sentinel, which agreed to defend the suit under a reservation of rights.[111]

Although Sentinel accepted the defense, Sentinel informed Honofed that its investigation revealed that much of the damage claimed was not covered by Sentinel's policies because the damage appeared to have occurred during periods of time outside Sentinel policy periods.[112] Consequently, Sentinel

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[105] Sentinel Ins. Co. v. First Ins. Co. of Haw., 76 Haw. 277, 287, 875 P.2d 894, 904 (1994) (emphasis added).

[106] *Sentinel*, 76 Haw. 277, 875 P.2d 894; Dairy Rd. Partners v. Island Ins. Co., 92 Haw. 398, 992 P.2d 93 (2000).

[107] 76 Haw. 277, 875 P.2d 894.

[108] *Id.* at 287-290, 875 P.2d at 904-907.

[109] *Id.* at 284, 875 P.2d at 901.

[110] *Id.* at 284-285, 875 P.2d at 901-902.

[111] *Id.* at 285, 875 P.2d at 902.

[112] *Id.*

advised Honofed to notify other liability insurers covering periods outside Sentinel's policy periods.[113] After Honofed notified First Insurance, the insurer disclaimed any responsibility and refused to contribute to the defense.[114] First Insurance argued that the damage was "first discovered" at a time when First was not "on the risk"; therefore, the entire risk should be allocated to the insurer covering the first manifestation of the damage.[115]

Ultimately, the underlying case settled for less than the policy limits under any single year.[116] Sentinel and Honofed jointly contributed $75,000 to the settlement, and Sentinel paid an additional $48,642.37 in attorneys' fees to defend the underlying action.[117] Sentinel then filed suit against First Insurance seeking contribution for the costs of defense and settlement.[118] The circuit court determined that because First Insurance had a duty to defend and wrongfully failed to defend, it was obligated to contribute to the settlement and defense costs.[119]

On appeal, the Hawai'i Supreme Court established the analytic framework to determine whether an insurer has a duty to defend. The court first examined the First Insurance policy language.[120] Invoking an enduring tenet of insurance law, the court instructed that insurance provisions defining the insurer's duty to defend are construed broadly and liberally in favor of the insured:

> "the obligation to defend . . . is broader than the duty to pay claims and arises wherever there is the mere *potential* for coverage." . . . In other words, the duty to defend "rests primarily on the *possibility* that coverage exists. This possibility may be remote, but if it exists[,] the [insurer] owes the insured a defense." . . . "All doubts as to whether a duty to defend exists are resolved against the insurer and in favor of the insured[.]"[121]

Next the court tested the policy language versus the allegations of the underlying claim against the insured to determine whether the allegations raised the possibility that the insured would be entitled to indemnification under the

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[113] *Id.*

[114] *Id.*

[115] *Id.* at 286, 875 P.2d at 903.

[116] The settlement within a single policy limit means that another important legal issue remains undecided. Other courts are divided on the high-stakes issue of how much coverage is available when a tort continues over multiple coverage periods. Does the insured obtain the coverage limit of a single policy, or can multiple policies be stacked to expand the amount available? *See* Thomas M. Jones & Jon D. Hurwitz, *An Introduction to Insurance Allocation Issues in Multiple Trigger Cases*, 10 VILL. ENVTL. L.J. 25 (1999) (discussing the apportionment of liability for insureds with multiple insurance policies).

[117] *Sentinel*, 76 Haw. at 285, 875 P.2d at 902.

[118] *Id.* at 285-286, 875 P.2d at 902-903.

[119] *Id.* at 286, 875 P.2d at 903.

[120] *Id.* at 287, 875 P.2d at 904.

[121] *Id.* (emphases in original; internal citations omitted).

policy.[122] The underlying complaint against Honofed alleged that the property was damaged by water infiltration caused by construction defects,[123] but the complaint did not specify whether the damage occurred during any particular policy period.[124] Relying on *Standard Oil Co. of California v. Hawaiian Insurance & Guaranty Co.*,[125] the court explained the following principle:

> [a]n insurer must look beyond the effect of the pleadings and must consider any facts brought to its attention or any facts which it could reasonably discover in determining whether it has a duty to defend .... The possibility of coverage must be determined by a good faith analysis of all information known to the insured or all information reasonably ascertainable by inquiry and investigation.[126]

Accordingly, a court must now conduct the following analysis to determine if an insurer's refusal to defend is justified: (1) the court must review the relevant policies and allegations of the underlying complaint, and (2) if the complaint is not clear, the court must also review all information known to the insurer or reasonably ascertainable by inquiry and investigation by the insurer at the time it made its decision.[127]

Additionally, the court in *Sentinel* expanded the duty to defend beyond factual possibilities raised by the underlying claim and held that the duty encompassed possibilities raised by unsettled legal theories as well. At the time First Insurance declined to defend based on a "manifestation of loss trigger," the law in Hawai'i was unsettled.[128] In fact, whether the insurer providing

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[122] *Id.*

[123] It is interesting to note that *Sentinel* never raised the question of whether construction defects constitute an "occurrence" under the CGL policies at issue. *See id.*, 76 Haw. 277, 875 P.2d 394. In contrast, the ICA recently decided that construction defects are not an "occurrence" under a liability policy, but instead constitute a breach of contract by the insured, thus eliminating the possibility of coverage. *See* Group Builders v. Admiral Ins. Co., 123 Haw. 142, 231 P.3d 67 (App. 2010).

[124] A typical CGL policy defines property damage to include "physical injury to or destruction of tangible property which occurs *during the policy period*, including loss of use thereof at a time resulting therefrom ...." *Sentinel*, 76 Haw. at 287, 875 P.2d at 904 (emphasis in original).

[125] 65 Haw. 521, 527, 654 P.2d 1345, 1349 (1982).

[126] *Sentinel*, 76 Haw. at 288, 875 P.2d at 905 (quoting *Standard Oil Co.*, 65 Haw. at 527, 654 P.2d at 1349).

[127] *Id.* at 288, 875 P.2d at 905. The principle was later reinforced by the court's decision in *Tri-S Corp. v. Western World Insurance Co.*, 110 Haw. 473, 497, 135 P.3d 82, 106 (2006).

[128] The relevant policies provided indemnification for "occurrences" that resulted in property damage "which occurs during the policy period." The court explained that under the manifestation of loss trigger, "property damage occurs when the latent defect first manifests itself, and the insurer on the risk at the time of first manifestation is solely liable for the entire loss, even if the property damage progresses after the policy expires." *Sentinel*, 76 Haw. at 297, 875 P.2d at 914 (quoting Chemstar, Inc. v. Liberty Mut. Ins. Co., 797 F. Supp. 1541, 1548-49 (C.D. Cal. 1992)). The court eventually adopted the injury-in-fact trigger. *Id.* at 298-99, 875

coverage at the time of manifestation was solely responsible for the entire loss, even though a portion of the loss extended into subsequent policy periods, was a subject of dispute nationwide.[129]

The court rejected First Insurance's position on two grounds. The court not only rejected the "manifestation of loss" as the preferred causation theory when damage is ongoing,[130] it also held that insurers must defend insureds in the face of an unanswered question of law. The court explained, "[t]he mere fact that the answers to those questions in this jurisdiction were not then and are not presently conclusively answered demonstrates that, based on the allegations in the underlying action, it was *possible* that the Honofed entities would be entitled to indemnification under the First Insurance policies."[131] As the duty to defend rests primarily on the *possibility* that coverage exists, the determination that First Insurance had a duty to defend was affirmed.[132]

The court then prescribed the consequences where the insurer wrongfully refuses to defend: "Where the insured seeks indemnification after the insurer has breached its duty to defend, (1) coverage is rebuttably presumed, (2) the insurer bears the burden of proof to negate coverage, and (3) where relevant, the insurer carries its traditional burden of proof that an exclusionary clause applies."[133] These penalties reflect a moderate approach. The court acknowledged that a "fair number of jurisdictions" adhere to a far more pro-insured rule that prohibits an insurer from "taking the position that the judgment or settlement did not involve a covered risk" after wrongfully declining to defend.[134] However, drawing a sharp distinction between coverage and the duty to defend, the court concluded that precluding a breaching insurer from challenging coverage altogether would unfairly penalize an insurer and might provide a windfall to the insured.[135]

P.2d at 915-16. Under this trigger, "an injury occurs whether detectable or not; in other words, an injury need not manifest itself during the policy period, as long as its existence during that period can be proven in retrospect." *Id.* at 298, 875 P.2d at 915.

[129] *Id.* at 289, 875 P.2d at 906.

[130] *Id.* at 301, 875 P.2d at 918.

[131] *Id.* at 290, 875 P.2d at 907 (emphasis in original).

[132] *Id.* The Ninth Circuit Court of Appeals qualified *Sentinel*'s legal ambiguity holding. In *Burlington Insurance Co. v. Oceanic Design & Construction, Inc.*, it held that under *Sentinel* the mere fact that a legal question is unanswered in Hawai'i is insufficient to create a possibility of coverage. 383 F.3d 940, 952-53 (9th Cir. 2004). Instead, the Ninth Circuit interpreted *Sentinel* to require a "level of uncertainty" amounting to a "notable dispute nationwide" to trigger coverage. *Id.* at 953.

[133] *Sentinel*, 76 Haw. at 297, 875 P.2d at 914 (citing Polaroid Corp. v. Travelers Indem. Co., 610 N.E.2d 912, 922 n.22 (Mass. 1993)).

[134] *Id.* at 295, 875 P.2d at 912. In doing so, the court rejected *Gray v. Zurich Insurance Co.*, 419 P.2d 168 (Cal. 1966), and the so-called "Illinois Rule" that effectively precludes an insurer that breaches the duty to defend from disputing grounds for coverage. *Id.*

[135] *Id.*

Chief Justice Moon's decision in *Sentinel* firmly establishes that the duty to defend broadly exists whenever there is any possibility of coverage under the policy language, whether that possibility exists based on unresolved facts or law. In *Sentinel*, the court also struck a middle ground in prescribing the consequences an insurer bears for breaching that duty, by nevertheless allowing insurers to challenge whether the claim was covered. While the court imposed some penalties upon insurers, particularly with regard to their burden of proof on coverage, it stopped short of holding that once an insurer wrongfully refuses to defend and abandons the insured, it loses its right to challenge the insured on the coverage issue.

B. The Duty to Defend on Disputed Facts

Dairy Road Partners v. Island Insurance Co.,[136] a unanimous opinion authored by Justice Levinson, clarified the extent to which a liability insurer could look beyond the pleadings to avoid the duty to defend. The underlying facts in *Dairy Road* were straightforward. Garth Nakamura, the son of the Kahului Shell station manager, was involved in an after-hour drinking binge at the Shell station.[137] Thereafter, Nakamura was driving home when his vehicle struck and killed pedestrian Alvin K. Vierra, Jr.[138] Suits against Nakamura, Shell, and Dairy Road alleged that Nakamura was employed by Dairy Road and was acting within the scope of his employment when he caused the accident that killed Vierra.[139]

Dairy Road was insured under four liability policies issued by Island Insurance that potentially provided coverage for the defendants: (1) a business auto policy; (2) a commercial garage liability policy; (3) a commercial general liability policy; and (4) a commercial umbrella policy.[140] The commercial garage liability policy, under which a duty to defend was eventually found, stated Island Insurance had "the right and the duty to defend any suit asking for . . . damages. However we have no duty to defend suits for bodily injury or property damage not covered by this policy."[141] The policy considered employees as insureds, but only while acting within the scope of their duties.[142]

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[136] 92 Haw. 398, 992 P.2d 93 (2000).

[137] *Id.* at 403, 992 P.2d at 98.

[138] *Id.*

[139] *Id.* Shell was alleged to be vicariously liable but was apparently dismissed prior to the appeal. *Id.* at 402 n.1, 992 P.2d at 97 n.1.

[140] *Id.* at 403-04, 992 P.2d at 98-99. Only the issues related to defense under the garage liability policy will be discussed here.

[141] *Id.* at 405, 992 P.2d at 100.

[142] *Id.*

Further, the policy only covered specific autos, including those of employees while used in the insured's garage business.[143]

Dairy Road and Shell tendered the defense of the Vierra suit to Island Insurance, but Island declined to assume their defense.[144] Island maintained that its investigation had revealed that prior to the accident Nakamura had been off duty, drinking with friends, and driving his personal vehicle home from the service station.[145] Therefore, Island asserted that the accident was not covered by Dairy Road's various liability policies.[146]

Dairy Road and Shell then filed suit seeking a declaration that Island was obligated to defend and indemnify them in the underlying lawsuits.[147] Island moved for summary judgment. In support of its motion, Island included portions of Nakamura's deposition in which Nakamura conceded that the consumption of alcohol was not permitted at the station, that the gathering the night of the accident was unauthorized, and that he was driving a friend home from the after-hours party when the accident occurred.[148] The circuit court denied Island's motion in part, holding that under the garage policy there was a genuine issue of material fact as to whether Nakamura's actions were necessary or incidental to the business.[149]

The parties appealed from lower court rulings on cross motions for summary judgment.[150] The salient issue on appeal regarding the duty to defend on the garage policy was whether Island could rely upon factual evidence outside the complaint's allegations to terminate its duty to defend.[151] Relying on *Sentinel*, the Hawai'i Supreme Court reiterated that an insurer bears a heavy burden in establishing that it has no duty to defend an insured. It again explained that an insurer's duty is broad, arising whenever there is a possibility of coverage based on the underlying claims, and that "[a]ll doubts [. . .] are resolved against the insurer and in favor of the insured."[152] It noted that Island's burden of proof was great, while Dairy Road's was slight:

> Island bore the burden of proving that there was no genuine issue of material fact with respect to whether a *possibility* existed that [Dairy Road] would incur liability for a claim covered by the policies. In other words, Island was required

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[143] *Id.* at 406-407, 992 P.2d at 100-01.

[144] *Id.* at 407, 992 P.2d at 102.

[145] *Id.*

[146] *Id.* at 407-08, 992 P.2d at 102-03.

[147] *Id.* at 408, 992 P.2d at 103.

[148] *Id.*

[149] *Id.* at 409-10, 992 P.2d at 104-05.

[150] *Id.*

[151] *Id.* at 413-14, 992 P.2d at 108-09.

[152] *Id.* at 412, 992 P.2d at 107 (quoting Trizec Prop., Inc. v. Bitmore Constr. Co., 767 F.2d 810, 812 (11th Cir. 1985)).

> to prove that it would be *impossible* for the [underlying plaintiffs] to prevail against [Dairy Road] in the underlying lawsuits on a claim covered by the policies. Conversely, [Dairy Road]'s burden with respect to its motion for summary judgment was comparatively light, because it had merely to prove that a *possibility* of coverage existed.[153]

Dairy Road then broke new ground in Hawai'i law by considering the extent to which an insurer may rely on extrinsic evidence—evidence outside the plaintiff's complaint—to determine whether it had a duty to defend. The gist of the conflict in this case was that, while the complaint in the underlying lawsuit alleged that Nakamura was acting within the course and scope of employment, a fact which implicated garage operations under the insurance policy, the uncontested facts adduced after the underlying complaint was filed established that Nakamura was not acting in the course and scope of employment.[154] Thus, relying on extrinsic evidence would favor the insurer by negating rather than creating a potential basis of coverage.

Just as it had done in *Sentinel*, the court again drew a sharp distinction between the duty to defend and the duty to indemnify. While the duty to defend is determined at the outset of the case and arises irrespective of the outcome, the duty to indemnify turns on establishing liability at the outcome of the underlying case.[155]

The court emphasized that the duty to defend depends on finding any possibility of coverage based on the policy language and the allegations in the underlying complaint.[156] The court conceded that earlier decisions had left Hawai'i law unclear as to the appropriate use of evidence beyond the underlying pleadings to establish the insurer's duty to defend.[157] It noted that under the commercial garage liability policy, the underlying complaints unambiguously triggered the possibility of coverage and therefore established a duty to defend.[158] Thus, in this case there was no need to rely on any extrinsic evidence to trigger the duty to defend at the outset.[159]

The court then explored the role of extrinsic evidence in establishing and disclaiming a duty to defend. To begin with, the court continued adherence to a rule first announced in *Standard Oil Co. of California v. Hawaiian Insurance*

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[153] *Id.* at 412-13, 992 P.2d at 107-08 (emphases in original; citation omitted).

[154] *Id.* at 423, 992 P.2d at 118.

[155] *Id.* at 413-14, 992 P.2d at 108-09.

[156] *Id.*

[157] *Id.* at 415-17, 992 P.2d at 110-12 (discussing Hawaiian Ins. & Guar. Co. v. Blanco, 72 Haw. 9, 804 P.2d 876 (1990); Hawaiian Ins. & Guar. Co. v. Brooks, 67 Haw. 285, 686 P.2d 23 (1984)).

[158] *Id.* at 414, 992 P.2d at 109.

[159] *Id.* at 415, 992 P.2d at 110.

& Guaranty Co.,[160] that when the underlying pleadings do not clearly allege a covered claim, the insurer "must look beyond the effect of the pleadings and must consider any facts brought to its attention" to establish a duty to defend.[161] However, striking a moderate position, the court rejected cases in other jurisdictions that more broadly impose upon insurers an obligation to assume a defense where the pleadings unambiguously negate coverage but an investigation of extrinsic facts would raise a possibility of coverage.[162]

The court next considered whether, once the duty to defend was triggered, an insurer was permitted to use extrinsic evidence to overcome the duty to defend. Island argued that a trio of earlier Hawai'i cases had allowed the insurer to look beyond the pleadings and conduct a factual investigation in order to avoid a duty to defend: *Hawaiian Insurance & Guaranty Co. v. Brooks*;[163] *Hawaiian Insurance & Guaranty Co. v. Blanco*;[164] and *Bayudan v. Tradewind Inc. Co.*[165] The court noted that those cases attempted "to ensure that plaintiffs could not, through artful pleading, bootstrap the availability of insurance coverage under an insured defendant's policy by purporting to state a claim for negligence based on facts that, in reality, reflected manifestly intentional, rather than negligent, conduct."[166] But this time the court was troubled by the unanticipated consequences that looking beyond the pleadings could have on the duty to defend.[167]

The court decided that the implication of these cases went too far and might deprive an insured of a deserved defense:

> One consequence . . . is that the insured may be saddled with the Procrustean dilemma of being forced to adduce facts proving his or her own liability in the underlying lawsuit in order to satisfy the insurer that there may be merit to the underlying covered claim. . . .
>
> Additionally, . . . the potential for inconsistent judgments [exists]. A circuit court presiding over a declaratory judgment action might rule, based on an insurer's superior production of evidence concerning material facts that will be directly in dispute in the underlying lawsuit, that there is no possibility of coverage. Subsequently, the trier of fact in the underlying lawsuit, not bound by

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[160] 65 Haw. 521, 654 P.2d 1345 (1982).

[161] *Dairy Road*, 92 Haw. at 414, 992 P.2d at 109 (quoting *Standard Oil Co.*, 65 Haw. at 526, 654 P.2d at 1349).

[162] *Id.* at 415 n.9, 992 P.2d at 110 n.9 (noting and rejecting the more expansive view adopted in *Spruill Motors, Inc. v. Universal Underwriters Insurance Co.*, 512 P.2d 403 (Kan. 1973), and *Gray v. Zurich Insurance Co.*, 419 P.2d 168 (Cal. 1966)).

[163] 67 Haw. 285, 686 P.2d 23 (1984).

[164] 72 Haw. 9, 804 P.2d 876 (1990).

[165] 87 Haw. 379, 957 P.2d 1061 (App. 1998).

[166] *Dairy Road*, 92 Haw. at 417, 992 P.2d at 112.

[167] *Id.*

> the ruling in the declaratory judgment action (the latter having no preclusive effect upon a non-party putative plaintiff), and perhaps relying upon different evidence adduced by the injured plaintiff, might find that the insured *is* liable on a claim covered by the policy. Such a result would be fundamentally unfair to the insured, inasmuch as, in retrospect, there must have been a possibility of coverage if, in fact, it is so adjudicated in the underlying lawsuit. Inasmuch as the circuit court would already have ruled that there was no possibility of coverage, and therefore no duty to defend, the insured would be barred by *res judicata* from recovering post-trial attorney's fees and costs from the insurer.[168]

Noting a split of authority in other jurisdictions on whether an insurer may use extrinsic evidence to disclaim its duty to defend, the court adopted the majority rule: "the insurer may only disclaim its duty to defend by showing that *none* of the facts upon which it relies might be resolved differently in the underlying lawsuit."[169] Accordingly, the court held that Dairy Road was entitled to partial summary judgment on the duty to defend under the commercial garage liability policy.[170] The court hedged a bit, however, adopting a "limited exception" to the majority rule, allowing "an insurer to rely upon extrinsic facts to disclaim liability only when the relevant facts 'will not be resolved by the trial court of the third party's suit against the insured.'"[171]

In summary, *Dairy Road* expounded upon that basic principle of liability insurance that insurers have a duty to defend whenever there is a potential for coverage. It established rules for the use of extrinsic evidence in instances where that evidence proves or disproves the possibility of coverage and established a rule that is favorable to insureds. First, *Dairy Road* provided that the duty to defend is principally determined by the claims in the underlying case, and an insurer may not turn to extrinsic evidence to disclaim that duty when the pleadings allege a potentially covered claim. Second, it continued to adhere to the rule stated in *Standard Oil* that when pleadings do not clearly allege a covered claim, the insurer may not simply deny a defense but must instead first consider extrinsic evidence that points to a potential for coverage. The court, however, also articulated several caveats to moderate these pro-insured rules. The court advised that under *Standard Oil*, insurers need not

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[168] *Id.* (emphases in original)

[169] *Id.* at 422, 992 P.2d at 117 (emphasis in original).

[170] *Id.* at 423, 992 P.2d at 118. The court also found a duty to defend under the business auto policy because there were genuine issues of fact regarding whether the policy included coverage for Nakamura's truck. *Id.* at 426, 992 P.2d at 121.

[171] *Id.* at 418, 992 P.2d at 113 (quoting Hartford Accident & Indem. Co. v. Aetna Life & Cas. Ins. Co., 483 A.2d 402, 406 (N.J. 1984)). The *Hartford Accident* court explained, "if a policy covered a Ford but not a Chevrolet also owned by the insured, the carrier would not be obligated to defend a third party's complaint against the insured which alleged the automobile involved was the Ford when in fact the car involved was the Chevrolet." *Hartford Accident*, 483 A.2d at 406.

conduct an investigation to establish a potentially covered claim when the pleadings do not allege one. Additionally, the court held that not all extrinsic evidence is barred when deciding whether an insured has a duty to defend. Furthermore, the court allowed insurers to consider extrinsic evidence to disclaim the duty to defend when that evidence would not be resolved differently in the underlying lawsuit.[172]

C. *The Significance of* Sentinel *and* Dairy Road

Through these decisions, the Hawai'i Supreme Court during the Moon years joined the vast majority of jurisdictions that determine the existence of a duty to defend based on whether the underlying allegations present a possibility of coverage under the policy.[173] Generally, the decisions regarding the insurer's duty to defend are favorable to the insured. *Sentinel*'s rule that insurers must defend whenever the law is unsettled prevents insurers from asserting untested legal positions unilaterally to deny a defense, and *Dairy Road* preserves the insured's right to a defense in the liability suit based upon what the plaintiff claims, regardless of how the facts might later emerge.

Notably, however, the Moon Court, in *Sentinel*, imposed only limited sanctions against insurers who abandon their insureds, not nearly as harsh as some jurisdictions have established. *Dairy Road* placed two restrictions on the insurer's defense obligation. First, as a limitation on *Standard Oil*, the court decided the insurer has no duty to search for extrinsic evidence to create the potential of coverage where the underlying allegations demonstrate there is no coverage under the policy. Second, the court allowed the use of extrinsic

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[172] Ultimately, the court held that Island had no continuing duty to defend because it held there was no duty to indemnify Dairy Road. The undisputed facts from Nakamura's deposition established that the accident occurred (1) ten hours after he finished his work day, (2) while he was driving home, and (3) after having given a ride to a friend. *Dairy Road*, 92 Haw. at 423, 992 P.2d at 118. Therefore, the court granted summary judgment to Island on the duty to indemnify. *Id.* This, according to the court, effectively terminated its duty to defend. *Id.* It seems contradictory to refuse to allow extrinsic facts to determine the duty to defend, but to allow it to decide coverage during an ongoing case. Significantly, the court suggested that an insured might seek a stay "pending the adjudication of the underlying lawsuit" in response to a declaratory action on indemnification to avoid this paradoxical result. *Id.* at 413 n.8, 992 P.2d at 108 n.8.

[173] *See* Westport Ins. Corp. v. Energy Fin. Servs. LLC, No. 08-5046, 2009 U.S. App. LEXIS 6218, at *7 (6th Cir. Mar. 29, 2009) (noting the majority of jurisdictions have adopted the rule that "if there is any allegation in the complaint which potentially, possibly or might come within the coverage of the policy, then the insurance company has a duty to defend"); GC Fin., LLC v. Old Republic Nat'l Title Ins. Co., No. 3:06-0913, 2008 U.S. Dist. LEXIS 81385, at *23-24 (M.D. Tenn. Sept. 30, 2008) (noting that "it is accepted in the overwhelming majority of jurisdictions that the obligation of a liability insurance company to defend . . . is to be determined solely by the allegations in the complaint").

evidence in determining the duty to defend where relevant facts will not be resolved differently in the underlying case. Consequently, the court adopted a moderate approach to the duty to defend that holds some advantages to both insureds and insurers.

IV. COMMERCIAL GENERAL LIABILITY POLICIES[174]

The CGL policy is the principal form of insurance covering businesses against liability for bodily injury and property damage. Thus, how courts interpret CGL coverage provisions can have a substantial economic impact on an industry. Two important cases, *Sentinel* and *Hawaiian Holiday*, provided important guidance on the meaning of an "occurrence" under a CGL policy in Hawai'i.

A. Trigger of Coverage Implications When Multiple Insurers Are on the Risk

During the mid- to late-1980s, then-Circuit Court Judge Ronald T.Y. Moon presided over many settlement conferences involving complex construction litigation. Construction litigation commonly involves multiple defendants whose defective work is alleged to have caused property damage over a period of years. CGL policies are typically issued for one-year periods of time. Thus, construction litigation potentially implicates multiple liability insurance policies for each defendant, sometimes issued by different insurers. Settlement of these cases was often frustrated by the defendants' liability insurers taking adverse positions on the applicable "trigger of coverage," which affected whether the insurer would be obligated to indemnify the insured defendant against eventual liability. For example, under the "manifestation of loss" trigger, property damage occurs when a latent construction defect first manifests itself, and the insurer on the risk at the time of first manifestation is solely liable for the entire loss, even if the property damage progresses after the policy expires.[175] Under the "exposure" trigger, coverage is triggered each time a person or property is exposed to a damage-causing agent.[176] Under the "injury-in-fact" trigger, coverage is triggered by the actual occurrence during the policy period of an injury-in-fact.[177] Not surprisingly, because the trigger of coverage affected which insurer or insurers would be obligated to pay the construction defect claim, an insurance company advocating a particular trigger of coverage in one

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[174] The principal author of this section was Keith K. Hiraoka of Roeca Luria Hiraoka LLP.

[175] Sentinel Ins. Co. v. First Ins. Co., 76 Haw. 277, 297, 875 P.2d 894, 914 (1994).

[176] *Id.*

[177] *Id.* at 298, 875 P.2d at 915.

case might advocate for a different trigger of coverage in another case depending upon the facts of the lawsuit which it was being asked to settle.

In addition to clarifying an insurer's duty to defend, discussed in the previous section of this article, *Sentinel* adopted the "injury-in-fact" trigger of coverage for occurrence-based liability insurance policies.[178] Briefly, Sentinel Insurance Company and First Insurance Company of Hawai'i insured a developer at different times and disagreed as to when certain property damage first occurred.[179] First Insurance maintained that the "structural damage in the way of water infiltration and associated damage became evident no later than December of 1982,"[180] while Sentinel was on the risk.[181] Sentinel maintained that "[t]he [AOAO] indicated . . . that damage from the water infiltration . . . began on or about December 11, 1984"[182] while First Insurance was on the risk. After discussing the various triggers of coverage employed by different courts, the Hawai'i Supreme Court adopted the "injury-in-fact" trigger, reasoning that "the injury-in-fact trigger is compelled by the plain language of the policies, and it does not violate the objectively reasonable expectations of the parties or relevant policy considerations."[183]

Under the injury-in-fact trigger, an injury occurs whether detectable or not—that is, the injury need not manifest itself during the policy period so long as its existence during that period can be proven in retrospect.[184] The supreme court recognized that determining when an injury in fact occurs may be a difficult task requiring expert scientific evidence, but held that proof of the precise onset of injury was not necessary. The court also recognized that injury may, in fact, occur over the span of several years and held that, in such a situation, the "continuous injury" trigger of coverage may be employed to equitably apportion liability among insurers.[185]

> Under this theory, property damage is deemed to have "occurred" continuously for a fixed period (the "trigger period"), and every insurer on the risk at any time during that trigger period is jointly and severally liable to the extent of their policy limits, the entire loss being equitably allocated among the insurers. The trigger period begins with the inception of the injury and ends when the injury ceases. Before the continuous injury trigger may be applied, the party urging its

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[178] An "occurrence policy" provides coverage if the event insured against (the "occurrence") takes place during the policy period, irrespective of when the injured party's claim is actually presented. *Id.* at 288, 875 P.2d at 905 (citations omitted).

[179] *Id.* at 285, 875 P.2d at 902.

[180] *Id.*

[181] *Id.* at 286, 875 P.2d at 903.

[182] *Id.* at 285, 875 P.2d at 902.

[183] *Id.* at 298, 875 P.2d at 915.

[184] *Id.* at 297, 875 P.2d at 914.

[185] *Id.* at 300, 875 P.2d at 917.

> application must make two factual showings. It must be established that: (1) some kind of property damage occurred during the coverage period of each policy under which recovery is sought; and (2) the property damage was part of a continuous and indivisible process of injury.[186]

The effect of this decision has been to bring all of the insurers that have accepted payments of premiums to the table when an occurrence spans their coverage period.

B. Sharpening the Line between Contract and Tort

In 1994, the Moon Court also recognized the distinction between contract and tort in the liability insurance coverage context—a distinction that would continue to be made in a subsequent non-insurance-related opinion authored by Chief Justice Moon,[187] and which foreshadowed an important 2010 insurance decision by the ICA.[188]

In *Hawaiian Holiday*, the Hawai'i Supreme Court held that a claim for breach of contract did not allege an "occurrence" within the coverage of a CGL insurance policy.[189] The case arose from a dispute between Hawaiian Holiday, a corporation that grew, processed, and retailed macadamia nuts, and two limited partnerships.[190] Hawaiian Holiday had promoted the limited partnerships to investors in Dallas, Texas.[191] The limited partnerships' business plan was to lease real property in Hawai'i from Hawaiian Holiday, purchase macadamia nut seedlings from Hawaiian Holiday, and pay Hawaiian Holiday to plant and tend the seedlings on the leased property and to harvest the macadamia nut crop.[192] Hawaiian Holiday was then to purchase the harvested nuts from the limited partnerships for processing into retail nut products.[193] "Unfortunately," as noted by the supreme court, "the venture did not progress as expected[,]"[194] and the limited partnerships sued Hawaiian Holiday in federal court in Texas. The Texas complaint alleged that Hawaiian Holiday made fraudulent misrepresentations in soliciting the investors' purchase of

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[186] *Id.* at 298, 875 P.2d at 915 (citations omitted).

[187] *See* Francis v. Lee Enterprises, Inc., 89 Haw. 234, 971 P.2d 707 (1999).

[188] *See* Group Builders, Inc. v. Admiral Ins. Co., 123 Haw. 142, 231 P.3d 67 (App. 2010).

[189] Hawaiian Holiday Macadamia Nut Co. v. Indus. Indem. Co., 76 Haw. 166, 872 P.2d 230 (1994).

[190] *Id.* at 167, 872 P.2d at 231.

[191] *Id.* at 167-68, 872 P.2d at 231-32.

[192] *Id.*

[193] *Id.*

[194] *Id.* at 168, 872 P.2d at 232.

shares in the limited partnerships and breached its farming contracts with the limited partnerships.[195]

Hawaiian Holiday tendered the defense of the Texas lawsuit to its CGL insurer, Industrial Indemnity Company.[196] Industrial Indemnity declined to defend.[197] Hawaiian Holiday then sued the insurer in Hawai'i state court alleging bad faith failure to defend.[198] The circuit court held that the Texas complaint alleged a claim for "property damage" and entered summary judgment for Hawaiian Holiday.[199] The insurance company appealed.[200]

The Hawai'i Supreme Court reversed.[201] The circuit court determined that the Texas plaintiffs' allegation that many of the macadamia nut seedlings were damaged or killed constituted a claim for "property damage."[202] The supreme court, however, then stated that in order for coverage to potentially exist, the "property damage" had to have been caused by an "occurrence."[203] The term "occurrence" was defined by the insurance policy as: "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured."[204] The court held that the alleged property damage—the damage to and killing of the seedlings—was "part and parcel of the alleged acts committed by Hawaiian Holiday that resulted in the claims for breach of contract and fraud."[205] Hawaiian Holiday's breach of contract, the court held, was not accidental, and the property damage resulting from the breach of contract—for which the plaintiffs sought benefit of the bargain damages or restitution[206]—was not caused by an "occurrence."

The court concluded by drawing a distinction between claims sounding in tort and those sounding in contract:

> The [Texas] plaintiffs confined their claims for relief to claims for causes of action for breach of contract and fraud. These claims are not negligence claims resulting from accidental conduct. Because the CGL policy provides coverage for accidental conduct only, the underlying complaint did not allege any basis for

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195 *Id.*
196 *Id.*
197 *Id.*
198 *Id.*
199 *Id.*
200 *Id.* at 169, 872 P.2d at 233.
201 *Id.* at 167, 872 P.2d at 231.
202 *Id.* at 170, 872 P.2d at 234.
203 *Id.*
204 *Id.* (emphasis removed).
205 *Id.* at 171, 872 P.2d at 235.
206 *Id.* at 168, 872 P.2d at 232.

> recovery that was covered by the policy. Industrial, therefore, had no duty to defend Hawaiian Holiday.[207]

The sharpening of the line between tort and contract drawn during Chief Justice Moon's tenure signaled the beginning of a substantial contraction of coverage for construction litigation in Hawai'i.

C. Significance of Sentinel *and* Hawaiian Holiday

When an injury occurs over multiple policy periods, *Sentinel*'s interpretation of the trigger of coverage under a CGL "occurrence" policy expanded how many insurers could be on the risk for defense and indemnity. *Sentinel* also left important questions open. For example, questions remain regarding issues of stacking multiple insurance limits and in what order parties must pay where primary, excess, and retained risks cover multiple periods.[208] However, by providing that all insurers must participate in the cost of defense and indemnification when an injury occurs over several policy periods, the court's decision generally favored the interests of the insured.

The Moon Court would later reinforce the doctrinal distinction between tort and contract drawn in *Hawaiian Holiday* in *Francis v. Lee Enterprises, Inc.*,[209] a decision authored by Chief Justice Moon. The court in *Francis* held that a tort recovery, including a recovery of punitive damages, is not allowed for breach of a contract in the absence of conduct that violates a duty that is independently recognized by principles of tort law and that transcends the breach of the contract.[210] The ICA would later draw the same distinction—although directly citing neither *Hawaiian Holiday* nor *Francis*[211]—in a 2010 decision holding that breach of contract claims based on allegations of defective construction and tort claims deriving from those breach of contract claims are not covered under commercial general liability policies.[212]

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[207] *Id.* at 171, 872 P.2d at 235.

[208] *See* EnergyNorth Natural Gas, Inc. v. Certain Underwriters at Lloyd's, 934 A.2d 517, 524 (N.H. 2007) (identifying and discussing allocation and stacking approaches in continuous trigger cases).

[209] 89 Haw. 234, 971 P.2d 707 (1999).

[210] *Id.* at 235, 971 P.2d at 708.

[211] The ICA's opinion, *Group Builders, Inc. v. Admiral Insurance Co.*, 123 Haw. 142, 231 P.3d 67 (App. 2010), extensively discussed *Burlington Insurance Co. v. Oceanic Design & Construction, Inc.*, 383 F.3d 940 (9th Cir. 2004), which cited to both *Hawaiian Holiday* and *Francis*.

[212] *Group Builders*, 123 Haw. 142, 231 P.3d 67.

V. INSURER BAD FAITH[213]

In the court's 1996 *Best Place* decision, Hawai'i finally recognized a bad faith tort cause of action against insurers. In the four decades leading up to the decision, nearly every state had adopted some form of the tort of bad faith specifically against insurers.[214] The Hawai'i Supreme Court's late recognition of insurance bad faith can be explained in part by the dominant role the federal courts play in Hawai'i insurance law. With few domestic insurers, many important insurance issues are decided by the federal courts sitting in diversity.[215] In light of the mixed signals emanating from state court decisions,[216] Hawai'i's federal court had consistently held that Hawai'i law did not recognize the tort of insurance bad faith.[217]

The facts of *Best Place* were straightforward. Best Place, a first party insured, lost its floundering business in a suspicious fire.[218] For its part, Penn, the property insurer, balked at paying the claim, as Best Place was slow to submit its business records for examination.[219] As the stalemate progressed, Penn eventually broke off communications, ignoring Best Place's entreaties to settle the claim.[220] Best Place filed suit, alleging tortious breach of good faith and fair dealing.[221]

Justice Paula Nakayama, writing for a unanimous court, finally held that in Hawai'i "there is a legal duty, implied in a first- and third-party insurance contract, that the insurer must act in good faith in dealing with its insured, and a breach of that duty of good faith gives rise to an independent tort cause of action."[222] Thus, although *Best Place* involved first party insurance, there was no room to doubt that the court would recognize the tort in both the first- and third-party context.

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[213] The principal author of this section was Professor Hazel Beh.

[214] *See* Boyarski, *supra* note 3, at 848 (observing that Hawai'i was the forty-seventh state in the nation to recognize the tort "in either the first- or third-party context, or in some statutory form" and tracing recognition of the tort to *Comunale v. Traders & General Insurance Co.*, 328 P.2d 198 (Cal. 1958), and *Crisci v. Security Insurance Co.*, 426 P.2d 173 (Cal. 1967)).

[215] *See* Hazel Beh et al., *Emerging Insurance Issues*, 11 HAW. B.J. 6, 16 (2007) (Co-author Noelle Catalan discussing the role of federal courts in state insurance cases and exploring possible procedural and jurisdictional options to put cases before the state courts).

[216] *See* Boyarski, *supra* note 3, at 862-66 (discussing cases both acknowledging the trend in other states with approval yet also refusing to recognize bad faith in the at-will employment context).

[217] *See, e.g.*, Genovia v. Jackson Nat'l Life Ins. Co., 795 F. Supp. 1036 (D. Haw. 1992).

[218] Best Place, Inc. v. Penn Am. Ins. Co., 82 Haw. 120, 123, 920 P.2d 334, 337 (1996).

[219] *Id.*

[220] *Id.*

[221] *Id.*

[222] *Id.* at 132, 920 P.2d at 346.

In 1996, the decision to recognize the tort of insurer bad faith in *Best Place* was easy because nearly every state had adopted the tort of insurance bad faith at least in some form. The court's greater challenge was articulating the standard required to establish liability; after all, with four decades of national case law, a wide variety of legal standards existed for the court to consider.[223] The court reviewed the development of the tort nationally, and ultimately adopted California's "reasonableness" or negligence standard.[224] The standard is a middle-ground choice requiring the plaintiff to prove that the insurer acted in bad faith or took unreasonable action in dealing with its insured.[225] It was a middle-ground choice because, on one hand, by only requiring the plaintiff to prove that the insurer acted unreasonably, the insured need not prove that the insurer acted willfully, maliciously, or deliberately as would be required if the tort were characterized as intentional as it is in some jurisdictions.[226] On the other hand, the standard also granted latitude to insurers by not imposing a form of strict liability on insurers[227] for reasonable but erroneous business judgments and interpretations of its obligations under the insurance contract.[228]

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[223] *Id.* (observing that "there is a significant variation in the standards by which liability is imposed").

[224] *Id.*

[225] *Id.* at 133, 920 P.2d at 347.

[226] *Id.* at 132-33, 920 P.2d at 346-47 (citing Aetna v. Broadway Arms, 664 S.W.2d 463, 465 (Ark. 1984); Nat'l Savings Life Ins. Co. v. Dutton, 419 So. 2d 1357 (Ala. 1982); McCorkle v. Great Atl. Ins. Co., 637 P.2d 583, 587 (Okla. 1981)).

[227] For example, the Supreme Court of Rhode Island adopted a fiduciary standard in *Asermely v. Allstate Insurance Co.*, holding:

> It is not sufficient that the insurance company act in good faith. An insurance company's fiduciary obligations include a duty to consider seriously a plaintiff's reasonable offer to settle within the policy limits. Accordingly, if it has been afforded reasonable notice and if a plaintiff has made a reasonable written offer to a defendant's insurer to settle within the policy limits, the insurer is obligated to seriously consider such an offer. If the insurer declines to settle the case within the policy limits, it does so at its peril in the event that a trial results in a judgment that exceeds the policy limits, including interest. If such a judgment is sustained on appeal or is unappealed, the insurer is liable for the amount that exceeds the policy limits, unless it can show that the insured was unwilling to accept the offer of settlement. The insurer's duty is a fiduciary obligation to act in the best interests of the insured. Even if the insurer believes in good faith that it has a legitimate defense against the third party, it must assume the risk of miscalculation if the ultimate judgment should exceed the policy limits.

728 A.2d 461, 464 (R.I. 1999).

The Supreme Court of Appeals of West Virginia adopted an even stricter standard, holding that an insurer's failure to settle within policy limits when it has an opportunity to do so establishes "that the insurer has prima facie failed to act in its insured's best interest and . . . constitutes bad faith toward insured." Shamblin v. Nationwide Mut. Ins. Co., 396 S.E.2d 766, 776 (W. Va. 1990).

[228] *Best Place*, 82 Haw. at 133, 920 P.2d at 347 (citing Hanson v. Prudential Ins. Co. of Am.,

Allowing insurers to exercise reasonable business judgment without exposure to excess liability, even when that judgment is erroneous and harmful to the insured, is a theme that pervades Hawai'i cases.[229] The court has steadfastly asserted that erroneous decisions by an insurer alone would not amount to bad faith unless the insurer's conduct has also been "improper."[230] Similarly, even when there has been bad faith, the plaintiff must establish "something more" to warrant punitive damages.[231] "[T]he plaintiff must prove by clear and convincing evidence that 'the defendant has acted wantonly or oppressively or with such malice as implies a spirit of mischief or criminal indifference to civil obligations, or where there has been some wilful [sic] misconduct or that entire want of care which would raise the presumption of a conscious indifference to consequences.'"[232] Thus, Hawai'i's bad faith standard represents a middle approach that places a burden on the insured to prove some negligent culpability. However, by rejecting the notion that the erroneous judgment speaks for itself, the court pits David against Goliath, placing a formidable burden on insureds to ferret out impropriety.

B. The Significance of Best Place

The tort of insurance bad faith serves as an important check on insurer misconduct, and its recognition in Hawai'i was long overdue. In recognizing the tort, the court implicitly acknowledged its own obligation to police this uniquely unequal relationship between insured and insurer. It explained:

> the adhesionary aspects of an insurance contract further justify the availability of a tort recovery . . . . [A] bad faith cause of action in tort will provide the necessary compensation to the insured for all damage suffered as a result of insurer misconduct. Without the threat of a tort action, insurance companies have little incentive to promptly pay proceeds rightfully due to their insureds, as they stand to lose very little by delaying payment.[233]

The recognition of the tort of bad faith has a normative influence on insurers by prescribing standards of conduct, providing access to tort remedies, and promoting accountability.

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772 F.2d 580 (9th Cir. 1985); Opsal v. United Servs. Auto. Ass'n, 283 Cal. Rptr. 212 (App. 1991); Olive v. Great Am. Ins. Co., 333 S.E.2d 41 (N.C. App. 1985); Austero v. Nat'l Cas. Co., 148 Cal. Rptr. 653 (App. 1978)).

[229] *See, e.g.*, Guajardo v. AIG Haw. Ins. Co., 118 Haw. 196, 204, 187 P.3d 580, 588 (2008) (noting that it is a question of fact whether the insurer's refusal to consent to settlement was based on an "unreasonable" interpretation of its policy).

[230] *See, e.g., id.*; Enoka v. AIG Haw. Ins. Co., 109 Haw. 537, 551, 128 P.3d 850, 864 (2006).

[231] *Best Place*, 82 Haw. at 134, 920 P.2d at 348.

[232] *Id.* (quoting Masaki v. Gen. Motors Corp., 71 Haw. 1, 11, 780 P.2d 566, 572 (1989)).

[233] *Id.* at 132, 920 P.2d at 346.

VI. MOTOR VEHICLE INSURANCE LAW[234]

A. Qualification as an "Insured" or "Covered Person"

In *Dawes v. First Insurance Co. of Hawaii, Ltd.*,[235] the Moon Court ruled that a pedestrian, left stranded by a stalled, insured motor vehicle, was still "occupying" that vehicle when she was struck and killed by a driver of an uninsured motor vehicle after walking "twenty to twenty-five minutes and having traveled approximately one mile from the insured vehicle."[236] On its face, the majority opinion, drafted by Justice Levinson, appeared to defy the common understanding of the word "occupying," thereby eliciting a lively dissenting opinion from Chief Justice Moon.[237] However, the legacy of *Dawes* is the analytical framework it set up to analyze one's qualification as an "insured" or "covered person"—namely, "class one" insureds, i.e., the named insured and family members residing in the named insured's household; and "class two" insureds, i.e., persons occupying, operating, or using a covered auto.[238]

In *Dawes*, Eric Shimp, Elizabeth Jean Bockhorn, and two friends left a beach gathering in a vehicle owned by Shimp's father and insured by First Insurance.[239] Shimp's vehicle overheated, so the group parked the vehicle along the highway.[240] Rather than wait for a police officer to render aid, the group decided to walk to the Kona airport "to obtain alternative transportation and repair assistance."[241] "[A]fter walking alongside the shoulder of the

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[234] The principal author of this section was Honolulu attorney Michael N. Tanoue of The Pacific Law Group.

[235] 77 Haw. 117, 883 P.2d 38 (1994). Although *Dawes* was decided by the Moon Court, Chief Justice Moon (joined by ICA Judge Walter Heen) filed a dissenting opinion.

[236] *Id.* at 119, 883 P.2d at 40.

[237] *Id.* at 133-44, 883 P.2d at 54-65 (Moon, C.J., dissenting). In a concurring opinion rendered in *Liki v. First Fire & Casualty Insurance of Hawaii, Inc.*, 118 Haw. 123, 185 P.3d 871 (App. 2008), Judge Craig Nakamura of the ICA wrote, inter alia, "[a]lthough I feel constrained by *Dawes* to concur in this case, I write separately because I share the concern of the *Dawes* dissent . . . ." *Id.* at 131, 185 P.3d at 879 (Nakamura, J., concurring). Judge Nakamura continued, "If I were writing on a clean slate, I would adopt the analysis of the dissent in *Dawes* . . . ." *Id.*

[238] *See, e.g.*, Foote v. Royal Ins. Co. of Am., 88 Haw. 122, 962 P.2d 1004 (App. 1998) (ruling that plaintiff, who was the vice-president, treasurer, director, and fifty-percent shareholder of the corporation designated as the named insured, did not qualify as a class one insured because corporations cannot have family members and that the plaintiff did not qualify as a class two insured because he was not occupying, operating, or using an insured vehicle).

[239] *Dawes*, 77 Haw. at 119, 883 P.2d at 40.

[240] *Id.*

[241] *Id.*

highway—well clear of the pavement—for twenty to twenty-five minutes and having traveled approximately one mile from the insured vehicle," Bockhorn was struck and killed by an uninsured motor vehicle operated by an uninsured motorist.[242]

Jeanette Dawes, individually and as special administrator of her daughter Bockhorn's estate, asserted a claim for uninsured motorist (UM) benefits against First Insurance, the insurer of the vehicle owned by Shimp's father.[243] In response to First Insurance's denial of the claim, Dawes filed a complaint for declaratory judgment, seeking a judicial declaration of coverage; First Insurance responded by answering and asserting a counterclaim, praying for a contrary ruling.[244]

At the time of the accident, Hawai'i Revised Statutes sections 431:10-213 and 431:10C-301 governed UM benefits.[245] The majority pointed out that these statutes

> are considered to be remedial in nature designed to afford maximum protection to the state's residents, and to fill the gaps in compulsory insurance plans. Their purpose is to provide a remedy where injury is caused by an uninsured motorist; or, as has been more frequently stated, to provide a remedy to the innocent victims of irresponsible motorists who may have no resources to satisfy the damages they cause.[246]

Being remedial in nature, the majority noted that the two UM statutes must be "construed liberally in order to accomplish the purpose for which they were enacted."[247]

The majority then noted that two general principles apply to UM coverage: "[f]irst, *either* 'an insured *or* an insured vehicle must be involved in the accident in order to collect under the UM endorsement'";[248] and "[s]econd, 'almost all modern forms of UM coverage include *passengers*, or occupants, of an automobile injured by an uninsured motorist; indeed an exclusion of them would, in most states, be invalid."[249] As the majority indicated, these two

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[242] *Id.* at 119-20, 883 P.2d at 40-41.

[243] *Id.* at 119, 883 P.2d at 40.

[244] *Id.* at 120, 883 P.2d at 41.

[245] Currently, uninsured motorist (UM) coverage is governed only by H.R.S. section 431:10C-301. Section 431:10-213 was repealed by the Legislature in 1989, "[p]resumably . . . because it was substantially duplicative of HRS § 431:10C-301." *Dawes*, 77 Haw. at 122 n.2, 883 P.2d at 43 n.2.

[246] *Id.* at 123, 883 P.2d at 44 (quoting 8C JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 5067.45, at 41-46 (1981)) (footnotes omitted).

[247] *Id.* (quoting Flores v. United Air Lines, Inc., 70 Haw. 1, 12, 757 P.2d 641, 647 (1988)).

[248] *Id.* (quoting 12A GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 45:634, at 127 (R. Anderson & M. Rhodes eds., 2d ed. 1981)) (emphases in original).

[249] *Id.* at 123-24, 883 P.2d at 44-45 (quoting 8C JOHN ALAN APPLEMAN & JEAN APPLEMAN,

general principles coalesce and are typically reflected in a "two class paradigm" of "covered persons" in UM policies:

> [O]n the one hand, the named insured, and while resident of the same household, the spouse of any such named insured, and relatives of either; and on the other, those who use, with the consent, express or implied of the named insured, the vehicle to which the policy applies and those who are guests in such vehicle. . . . And second group persons are only covered when an accident takes place while they are occupying, operating or using the insured vehicle. This is to be contrasted with the fact that first group persons are not required to be associated with the insured auto in order for coverage to attach. . . . *Coverage for the first of the classes listed above, but not for the second, extends to injury suffered while a pedestrian.*[250]

Put another way,

> [i]njury received as a pedestrian generally is limited to the [first class], at least *unless some connection with the insured vehicle is shown.* . . . [N]ot every departure from a vehicle necessarily divorces one from his status as a covered passenger. One may be considered still to be "occupying" the vehicle if in reasonable relationship to it at the time of injury.[251]

The Moon Court then considered, but rejected, the Washington Court of Appeals' formula for determining whether the claimant has sufficient "connection with the insured vehicle" in order for a "class two-insured" to be entitled to UM benefits.[252] The court explained that tests requiring sufficient connection to the vehicle "fail . . . to avoid the anomaly that when 'class one' and 'class two' persons 'are travelling together, a different result may follow where injury is received by each.'"[253] The Moon Court then noted that it was "apparent . . . that application of the *Rau* test would result in the same anomaly had Shimp and Bockhorn both been struck and killed."[254] More specifically, "Shimp, as a covered 'family member,' would be entitled to UM benefits but Bockhorn would not, although both had been occupants of the insured vehicle

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INSURANCE LAW AND PRACTICE § 5080.45, at 255-56 (1981)) (emphasis in original). The majority noted that the word "passenger" means "any *occupant* of a vehicle other than the person operating it." *Id.* at 124 n.7, 883 P.2d at 45 n.7 (quoting BLACK'S LAW DICTIONARY 1123 (6th ed. 1990)) (emphasis in original). Thus, the majority elaborated, "for purposes of UM coverage, a 'passenger' is synonymous with a 'person occupying' a 'covered auto.'" *Id.*

[250] *Id.* at 126, 883 P.2d at 47 (quoting 12A GEORGE J. COUCH, CYCLOPEDIA OF INSURANCE LAW § 45:635, at 130-32 (R. Anderson & M. Rhodes eds., 2d ed. 1981)) (emphasis in original).

[251] *Id.* (quoting 8C JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 5092.35, at 381-82, 386-87 (1981)) (emphasis in original).

[252] Rau v. Liberty Mut. Ins. Co., 585 P.2d 157 (Wash. App. 1978).

[253] *Dawes*, 77 Haw. at 127, 883 P.2d at 48 (quoting 8C JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 5092.35, at 381 (1981)).

[254] *Id.*

and both were identically situated with respect to the uninsured Honda Accord."[255] In light of the remedial purpose of the UM statute, the Moon Court opined that "such a result is absurd."[256] "Indeed, [the Moon Court believed] that a layperson would be shocked to learn that such a result could be reached by way of legal intellectual gymnastics."[257]

The Moon Court then sternly reminded insurers that requiring "'covered persons' other than the named insured and 'family members' [to] be 'occupying a covered auto' (i.e., be occupying an insured vehicle) at the time of injury" under a UM policy was previously declared void "as conflicting with the Hawai'i UM statutes" in *National Union Fire Insurance Co. v. Olson*.[258] Because "class-two insureds" need not be "occupants" of an insured vehicle but must still have "some connection with the insured vehicle" in order to qualify for UM benefits, the Moon Court then turned to "the heart of Dawes' appeal: was Bockhorn a 'covered person' under the [First Insurance] auto policy at the time of the accident or was she not?"[259] To answer that question, the court revisited *Olson*,[260] which had held that an emergency medical technician setting a warning flare in the roadway was entitled to UM benefits, despite policy language limiting coverage to those occupying the vehicle.[261] While agreeing with the result, the court in *Dawes* retreated from the analysis that coverage extended only to "accidents resulting from activities prescribed 'in the immediate vicinity of the vehicle.'"[262]

Rejecting formulations that focused on connectedness or proximity, but mindful of the need for a sufficient "connection with the insured vehicle," the Moon Court adopted the "chain of events" test articulated by the Oklahoma Supreme Court in *Safeco Insurance Co. of America v. Sanders*:[263]

> (1) if a person was a passenger in an insured vehicle being operated by a named insured or a named insured's family member, (2) during the chain of events resulting in injury to the person caused by an accident involving an uninsured motor vehicle, (3) then the person is a "covered person" at the time of his or her injury to the same extent as the named insured or the named insured's family

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[255] *Id.*

[256] *Id.*

[257] *Id.* at 128, 883 P.2d at 49.

[258] *Id.* at 129, 883 P.2d at 50 (citing Nat'l Union Fire Ins. Co. v. Olson, 69 Haw. 559, 751 P.2d 666 (1988)).

[259] *Id.*

[260] *Olson*, 69 Haw. 559, 751 P.2d 666; *Dawes*, 77 Haw. at 130, 883 P.2d at 51.

[261] *Olson*, 69 Haw. at 564, 751 P.2d at 669.

[262] *Dawes*, 77 Haw. at 131, 883 P.2d at 52.

[263] 803 P.2d 688 (Okla. 1990).

> members would be entitled to receive UM benefits under the applicable UM policy.[264]

The Moon Court applied the "chain of events" test and ruled, as a matter of law, that Bockhorn was a "covered person" because:

> (1) Bockhorn was a passenger in the insured vehicle; (2) the insured vehicle was being operated by Shimp, a "family member" of the named insured; (3) the insured vehicle broke down; (4) as a result of the breakdown, the occupants of the insured vehicle, including Bockhorn, exited and proceeded on foot to the Kona airport in order to obtain alternative transportation and repair assistance; and (5) en route to the group's destination, Bockhorn sustained fatal injuries as a result of the operation of an uninsured vehicle by an uninsured motorist.[265]

Chief Justice Moon, with whom Substitute Justice Walter Heen joined, dissented on the ground that "the majority's analysis [ran] afoul of two fundamental tenets of statutory construction and imprudently adopted an overly broad rule that will lead to inequitable and undesirable results."[266] The dissent contended that the majority

> depart[ed] from the plain meaning of the statute and the legislative history, and adopt[ed] a rule that will ironically produce the absurd results it allegedly attempts to avoid . . . .[267] Under the majority's hypothetical [where both Shimp and Bockhorn are struck and injured], Shimp and Bockhorn were indeed both occupants of the vehicle at one time, and both were struck by the same vehicle. However, in the context of *insurance coverage*, the two are worlds apart.[268]

Under the hypothetical,

> Shimp derives his entitlement to coverage based on his status as a family member of a named insured, who entered into a contract of insurance with the insurer and paid premiums in exchange for coverage, not because he was an occupant of the vehicle. As a 'family member,' Shimp's coverage under the policy is relatively comprehensive.[269]

"Bockhorn's entitlement to coverage, however, would arise only by virtue of her status as an occupant of the Shimp Family's insured vehicle."[270]

After reviewing relevant portions of the legislative history, the dissent concluded that

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[264] *Dawes*, 77 Haw. at 133, 883 P.2d at 54.

[265] *Id.*

[266] *Id.* at 133, 883 P.2d at 54 (Moon, C.J., dissenting).

[267] *Id.* at 138, 883 P.2d at 59.

[268] *Id.* at 138-39, 883 P.2d at 59-60 (emphasis in original).

[269] *Id.*

[270] *Id.* at 139, 883 P.2d at 60.

> [t]he legislature made explicit its intent to accord full UM protection to a named insured and his or her family. Nowhere is there voiced a similar intent to accord coextensive coverage to passengers of insured vehicles, let alone former passengers, long since separated from the insured vehicle by time, space, and state of mind. . . . Here, the patent, sensible, and ultimately fair distinction as recognized by the legislature between Shimp and Bockhorn is that Bockhorn never paid a single premium to the insurer; accordingly she is not entitled to the same *scope of coverage* as Shimp. The supposed "absurdity" as set forth by the majority is unfounded and cannot form the basis in which to depart from the intent of the legislature.[271]

The dissent closed its criticism of the majority's new "chain of events" test by portending "virtually limitless coverage once a claimant has occupied an insured vehicle," especially because "[t]here is hardly any activity in our society which is not preceded by the use of an automobile."[272] In the dissent's view, a claimant would be entitled to UM coverage simply if he or she is injured by an uninsured motorist after occupying the insured vehicle, "regardless of time, physical distance, or, seemingly, even intervening events."[273] More importantly, the dissent pointed out that under the "chain of events" test, there is no need to examine why the claimant exited the insured vehicle in order to invoke coverage:

> Thus, whether the passenger leaves a vehicle because it breaks down or is simply parked, or because he or she was dropped off at some destination, according to the new rule, UM coverage continues to be extended to the former passenger for some undefined period of time or distance from the insured vehicle.[274]

Regardless of the ultimate holding of the majority and the dissenting opinion's sharp criticism of the majority opinion, the legacy of *Dawes* is its clear delineation and explanation of the different classifications of insureds or covered persons: class-one insureds, as the named insured and "family members"; and class-two insureds, as those occupying or having some connection with the insured vehicle.[275] These classifications have served and will continue to serve courts, insurance law practitioners, insurers, and insureds well whenever they attempt to analyze questions regarding a claimant's qualification for coverage under automobile insurance policies.[276]

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[271] *Id.* at 140, 883 P.2d at 61 (emphasis in original).

[272] *Id.* at 143, 883 P.2d at 64.

[273] *Id.*

[274] *Id.*

[275] As the dissent in *Dawes* points out, there is a third distinct classification of insureds—persons with respect to damages those persons are entitled to recover because of bodily injury sustained by class one or class two insureds. *Id.* at 139 n.7, 883 P.2d at 60 n.7 (quoting 1 ALAN I. WIDISS, UNINSURED AND UNDERINSURED MOTORIST INSURANCE § 4.1, at 59 (2d ed. 1992)).

[276] A fourth classification of covered persons under an automobile liability policy was

B. Determination of "Per Person" or "Each Person" Limits

In *First Insurance Co. of Hawaii v. Lawrence*,[277] Chief Justice Moon, writing for a unanimous court, ruled that, under Hawai'i's motor vehicle insurance law and the wording of First Insurance's policy, the claims of negligent infliction of emotional distress ("NIED") asserted by the parents of a decedent who were not involved "in" the motor vehicle accident that killed their son were derivative claims limited to a single "each person" limit of liability applicable to the "host" plaintiff. Frederick D. Lawrence, Jr. (Frederick) had been drinking beer with some friends, including Orlando Bitanga.[278] Frederick, an unlicensed minor who was allegedly intoxicated, drove a vehicle owned by Orlando Bitanga's older brother.[279] The police attempted to stop Frederick when they noticed he was having difficulty controlling the vehicle.[280] During the ensuing chase, Frederick struck and killed Christopher T.F.K. Smith, Jr., a pedestrian.[281] The decedent's family members "were not involved in nor did they witness the accident."[282] Smith's family filed suit against Frederick and his parents and asserted, among other claims, claims for NIED, loss of consortium, and wrongful death.[283] First Insurance took the position that these claims "were derivative and, therefore, subject to a single limit of liability coverage under the policy."[284] As a corollary, First Insurance also argued that "recovery for accidental harm is limited to persons at the accident scene."[285]

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analyzed in *AIG Hawai'i Insurance Co. v. Smith*, 78 Haw. 174, 891 P.2d 261 (1995). Chief Justice Moon, writing for a unanimous court, held that an automobile liability policy afforded "covered person" status to an alleged tortfeasor who transported alcohol to a beach party on the day of the accident. *Id.* at 176, 891 P.2d at 263. Neither the alleged tortfeasor, nor his vehicle, were actually involved in the accident. *Id.* The decision was perplexing. After quoting the relevant portion of the definition of "covered person"—what the court called "clause four"—and inserting the names of the individuals involved in the underlying lawsuit, the court reached a conclusion that is apparently neither grammatically nor syntactically correct. More importantly and of greater impact in the field of insurance policy drafting and insurance coverage analysis, the Moon Court clarified that an insurer's selective choice of labels for different classifications of insureds could create mutually exclusive classifications of insureds. *Id.* at 183, 891 P.2d at 270.

[277] 77 Haw. 2, 881 P.2d 489 (1994).

[278] *Id.* at 4, 881 P.2d at 491.

[279] *Id.*

[280] *Id.* at 5, 881 P.2d at 492.

[281] *Id.*

[282] *Id.*

[283] *Id.*

[284] *Id.* at 6, 881 P.2d at 493.

[285] *Id.*

The Moon Court analyzed the relevant statutory provision that abolished tort liability for accidental harm arising from motor vehicle accidents and its exceptions[286] and explained:

> Although the Smiths claim that their emotional distress claims *arose out of* a motor vehicle accident in which Christopher was killed, none of the Smiths sustained their accidental harm *in* the accident. Thus, the plain language of HRS § 294-6(a) appears to mandate that the Smiths are unable to bring a separate, independent suit for their alleged emotional distress.[287]

However, because the statute was "in derogation of principles of common law tort liability,"[288] the Moon Court's analysis did not end there. Rather, the court noted that the statute "must be strictly construed and, where it does not appear that there was a legislative purpose in the statute to supersede the common law, the common law applies."[289]

The Moon Court then "acknowlege[d] that within the tort context, there exists independent legal protection for NIED claims in this jurisdiction"[290] and that "[t]he absence of resulting physical injury is not a bar to recovery[.]"[291] In addition, "'there is no requirement that plaintiffs must actually witness the tortious event in order to recover,'"[292] such factors bearing instead on the "degree of emotional distress suffered."[293] The Moon Court observed, however, that "the crucial distinction . . . is that the Smiths' NIED claims are *not* being reviewed within a 'pure' tort context."[294]

"Because the Smiths' claims clearly originate from the primary claim—the death of Christopher[,]" the Moon Court concluded, "such claims are derivative . . . in the sense that their viability is dependent on the viability of the main

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[286] The statute provided, in relevant part, that tort liability is abolished "except as to the following persons or their personal representatives, or legal guardians, and in the following circumstances": "(1) Death occurs *to such person in such a motor vehicle accident* . . ."; "(2) Injury occurs *to such a person in a motor vehicle accident* in which the amount paid or accrued exceeds the medical-rehabilitative limit . . ."; and "(3) Injury occurs *to such person in such an accident* and as a result of such injury the aggregate limit of no-fault benefits . . . payable to such person are exhausted." *Id.* at 8, 881 P.2d at 495 (quoting HAW. REV. STAT. § 294-6(a)) (emphases in original). The current version of Hawai'i Revised Statutes section 294-6 is Hawai'i Revised Statutes section 431:10C-306.

[287] *Lawrence*, 77 Haw. at 8, 881 P.2d at 495 (emphases in original).

[288] *Id.*

[289] *Id.* (quoting Doi v. Hawaiian Ins. & Guar. Co., 6 Haw. App. 456, 465, 727 P.2d 884, 890 (1986)) (internal citations omitted).

[290] *Id.*

[291] *Id.* (citing Leong v. Takasaki, 55 Haw. 398, 403, 520 P.2d 758, 762 (1974)).

[292] *Id.* (quoting Campbell v. Animal Quarantine Station, 63 Haw. 557, 557, 632 P.2d 1066, 1066 (1981)).

[293] *Id.* (citing *Leong*, 55 Haw. at 403, 520 P.2d at 762).

[294] *Id.* at 9, 881 P.2d at 496 (emphasis added).

claim."[295] The motor vehicle insurance statute, the court said, "codifies the treatment of derivative claims consistent with the great majority of jurisdictions that do not allow separate 'each person' limits for derivative claims, including NIED. These courts have held that recovery of insurance proceeds for derivative claims [is] limited to a single 'each person' limit applicable to the 'host' plaintiff."[296]

Importantly, the Moon Court rejected the Smith family's argument that some derivative NIED claims could meet a separate tort threshold,[297] thereby potentially triggering separate "each person" limits. The court clarified that "[e]ven if one of the Smith claimants could meet one of the aforementioned thresholds, he or she must first meet the threshold requirement that his or her accidental harm occurred 'in' the accident. Moreover, meeting one of the aforementioned thresholds does not change the fact that his or her claim is 'derivative.'"[298]

In *Lawrence*, the court noted, it was "undisputed that the Smiths did not witness the accident nor were they 'timely present at the immediate scene of the accident.'"[299] However, the court forewarned that "if the Smiths had been witnesses to the event that caused Christopher's death, they would have *non-derivative* and wholly independent NIED claims that would trigger separate single limits under the policy as to each proven claim."[300]

Having concluded that the Smith family's NIED claims were derivative, the Moon Court then turned to the question of whether the motor vehicle insurance statute "is consistent with the proposition that derivative claims are limited to a single per person limit."[301] The relevant statute required, inter alia, that automobile insurance policies include liability coverage of not less than $35,000 *"for all damages arising out of accidental harm sustained by any one person as a result of any one accident applicable to each person sustaining accidental harm* arising out of ownership, maintenance, use, loading, or unloading, of the insured vehicle."[302] The statutory phrase "all damages,"

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[295] *Id.* at 9-10, 881 P.2d at 496-97.

[296] *Id.* at 10, 881 P.2d at 497.

[297] The tort thresholds referenced by the Smith family were the medical-rehabilitative limit (which was $6400 at the time of the accident) and the exhaustion of all no-fault benefits (which aggregate limit was $15,000 at the time of the accident). *Id.* at 11 nn.11-12, 881 P.2d at 498 nn.11-12. Under current law, the personal injury protection limit is $5000 and there is no comparable no-fault aggregate limit. *See* HAW. REV. STAT. § 431:10C-306(b) (2005).

[298] *Lawrence*, 77 Haw. at 11, 881 P.2d at 498.

[299] *Id.* at 13, 881 P.2d at 500 (quoting Crabtree v. State Farm Ins. Co., 632 So. 2d 736, 745 n.19 (La. 1994)).

[300] *Id.* (emphasis in original).

[301] *Id.*

[302] *Id.* (quoting HAW. REV. STAT. § 294-10(a)(1) (1985)) (emphasis in original). The current version of this statute is Hawai'i Revised Statutes section 431:10C-301(b)(1), the comparable

included in the longer phrase "all damages arising out of accidental harm sustained by any one person as a result of any one accident," the Moon Court noted, was construed by three Hawai'i decisions to include "derivative claims arising from the injury or death of the host plaintiff and are therefore subject to the 'one person' statutory minimum."[303] The Moon Court "agree[d] with the . . . analysis of all three courts and therefore h[e]ld that the no-fault statute does not require a separate statutory minimum to cover each of the Smiths' derivative NIED claims."[304]

The Moon Court ultimately held that "in the context of Hawai'i's no-fault law and under the limitation of liability provision in First Insurance's policy, emotional distress claims under the circumstances of this case are derivative and as such do not require separate 'each person' coverage to the Smiths."[305]

Eleven years later, in *Liberty Mutual Fire Insurance Co. v. Dennison*,[306] the Moon Court had an opportunity to more clearly define the rule that an NIED claim asserted by a family member of the host plaintiff is derivative and therefore entitled to only one "per person" limit, along with the "exception" that, if the family member was "in" the motor vehicle with the host plaintiff at the time of the collision or "witness[ed] the actual collision itself," such family member's NIED claim would be considered independent and subject to a separate "per person" limit.[307]

In *Dennison*, Tyrone Dennison (Tyrone), a teenager, suffered severe injuries, including brain damage, in a motor vehicle accident.[308] Both of Tyrone's parents, Donald H. Dennison (Donald) and Lynn Dennison, were not in the accident vehicle, and "they did not witness the actual collision."[309] Less than thirty minutes after the accident, the police went to the Dennison home and informed the Dennisons that Tyrone had been in an accident and they were going to transport him by helicopter to a nearby hospital.[310] At the time, Donald had already heard a helicopter overhead.[311] Immediately after speaking to the police officer, Donald "ran out the side door of his garage, jumped a wall

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portion of which provides that motor vehicle insurance policies shall include liability coverage not less than $20,000 per person, with an aggregate limit of $40,000 per accident, "for all damages arising out of accidental harm sustained as a result of any one accident and arising out of ownership, maintenance, use, loading, or unloading of a motor vehicle."

[303] *Lawrence*, 77 Haw. at 13, 881 P.2d at 500.

[304] *Id.* at 14, 881 P.2d at 501. The court then rejected the claim that First Insurance policy language provided for coverage even if the statute did not. *Id.* at 15-16, 881 P.2d at 502-03.

[305] *Id.* at 16, 881 P.2d at 503.

[306] 108 Haw. 380, 120 P.3d 1115 (2005).

[307] *Id.* at 384-85, 120 P.3d at 1119-20.

[308] *Id.* at 380, 120 P.3d at 1115.

[309] *Id.* at 382, 120 P.3d at 1117.

[310] *Id.*

[311] *Id.*

behind his house and ran to the triage area where the ambulance and firemen had congregated which was down the street from the site of the collision," an area about the length of a football field from his house.[312] Upon arriving at the triage area, Donald noticed two boys who appeared uninjured, so he knew the helicopter flying overhead was for his son.[313]

When Donald peered into the ambulance, he saw medical technicians and a fireman intubating a patient, whose face was partially covered.[314] Donald could not recognize his son until one of the medical technicians pointed out Tyrone, who was unconscious and completely unresponsive.[315] Donald realized his son's condition was serious when he saw the emergency workers intubating Tyrone, but no one could give Donald information about the extent of Tyrone's injuries other than to report that Tyrone would be flown to Queen's Medical Center.[316] The medical technician then took Tyrone from the ambulance and wheeled him by gurney to the waiting helicopter.[317] During this transport, Donald could see blood on Tyrone's face.[318]

The Moon Court identified the "sole issue" on appeal: "Whether Donald [was] precluded from making a claim on a separate policy limit of UIM coverage for his emotional distress allegedly suffered in the subject . . . motor vehicle collision, because Donald was not in the motor vehicle with his son Tyrone at the time of the collision and did not witness the actual collision itself?"[319] The court noted that "[a]lthough the parties in this case agree that, pursuant to HRS § 431:10C-306(b), Donald may not recover insurance benefits from Liberty Mutual unless he suffered emotional distress 'in' the . . . car accident, they disagree as to whether Donald was 'in' the accident for purposes of [that statute]."[320] Thus, the more fact-specific issue on appeal, according to the Moon Court, was "whether Donald, who was not a passenger in the [accident] car, did not witness the car accident, and arrived 'down the street from the site of the collision' approximately thirty minutes after the accident occurred, sustained his emotional distress 'in' the car accident" under the insurance code and could maintain an independent claim against the insurer.[321]

The Moon Court acknowledged that, in *Lawrence*, it had "recognized the potential for an independent claim by a family member for 'witnessing serious

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312 *Id.*
313 *Id.*
314 *Id.*
315 *Id.*
316 *Id.*
317 *Id.* at 383, 120 P.3d at 1118.
318 *Id.*
319 *Id.* at 384-85, 120 P.3d at 1119-20 (first brackets added and other brackets removed).
320 *Id.* at 385, 120 P.3d at 1120.
321 *Id.*

injury to a close relation coming onto the scene of the event soon thereafter[.]'"[322] However, the Moon Court ruled that the undisputed facts demonstrated that Donald did not "timely arrive at the immediate scene of the accident."[323] "Rather, Donald learned of the accident while at home and arrived at the 'triage area' which was 'down the street from the site of the collision,' . . . approximately thirty minutes after the accident occurred and saw Tyrone unconscious in the ambulance."[324] Thus, the Moon Court held that Donald was "precluded from asserting a separate and independent UIM benefits claim for his emotional distress."[325]

Justice Simeon Acoba dissented, observing that the *Lawrence* court had "acknowledged a corollary to the witness exception that included a claim of one 'timely present at the immediate scene of the accident,'" and recognized a "cause of action for witnessing serious injury to a close relation in either viewing the event causing the injury or *coming onto the scene of the event soon thereafter*."[326] "The parameters of the 'scene' and the measurement of the 'soon thereafter,'" Justice Acoba opined, should have been "issues to be determined by the fact finder on a case-by-case basis subject only to this court's determination on 'whether the case presents questions on which reasonable men would disagree.'"[327]

The significance of *Lawrence* and *Dennison* in the context of motor vehicle insurance law cannot be overstated. The classification of emotional distress claims as derivative versus independent, and the limitation of such recoveries to single versus multiple "per person" limits of insurance, help to safeguard one of the objectives of the motor vehicle insurance law—"to reduce the cost of motor vehicle insurance by establishing a uniform system of motor vehicle insurance."[328] While those who are "in" a motor vehicle accident may be entitled to assert independent NIED claims, those who are not "in" the accident and who therefore did not witness the collision are limited to asserting derivative NIED claims and recovering under the single "per person" limit available to the host claimant.

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[322] *Id.* at 388 n.8, 120 P.3d at 1123 n.8 (quoting *id.* at 389, 120 P.3d at 1124 (Acoba, J., dissenting)).

[323] *Id.* (quoting Crabtree v. State Farm Ins. Co., 632 So. 2d 736, 745 n.19 (La. 1994)).

[324] *Id.* at 388 n.8, 120 P.3d at 1123 n.8.

[325] *Id.* at 388, 120 P.3d at 1123.

[326] *Id.* at 389, 120 P.3d at 1124 (Acoba, J., dissenting) (emphasis added; citation omitted).

[327] *Id.* at 390, 120 P.3d at 1125 (quoting Rodrigues v. State, 52 Haw. 156, 175 n.8, 472 P.2d 509, 521 n.8 (1970)).

[328] AIG Haw. Ins. Co. v. Vicente, 78 Haw. 249, 256, 891 P.2d 1041, 1048 (1995) (citations and emphasis omitted). As the court stated, "the enactment of HRS ch. 431:10C benefits persons injured as a result of motor vehicle accidents, named insureds, and the automobile liability insurance industry." *Id.*

C. Settling UIM Claims without Exhausting Bodily Injury Liability Limits

In *Taylor v. Government Employees Insurance Co. (GEICO)*,[329] the Moon Court examined and ruled upon two common UIM provisions: the consent-to-settle clause and the exhaustion clause. In that case, Rosalina Taylor (Rosalina) was injured in a motor vehicle accident involving a tortfeasor insured by State Farm.[330] Rosalina and her husband, Emilio Taylor, were insured under their own automobile insurance policy, issued by GEICO, which included UIM coverage.[331] As a result of the injuries she sustained in the accident, Rosalina incurred medical expenses of $15,196.56, was given a medical discharge from the United States Navy, and obtained an economist's projection of $584,116.00 in future economic losses.[332]

After the Taylors filed suit against the tortfeasor, their attorney wrote to GEICO, the Taylors' UIM carrier, informing it that State Farm, the tortfeasor's carrier, had offered to settle the lawsuit in exchange for payment of $33,000.00, just $2000 under the State Farm limits of $35,000, subject to approval of the Taylors and GEICO.[333] The GEICO claims examiner refused to approve the settlement citing the exhaustion and consent to settle clauses of the policy.[334] The exhaustion clause of the GEICO policy provided that "we will not pay until the total of all bodily injury liability insurance available has been exhausted by payment of judgments or settlements."[335] The consent-to-settle clause provided that the UIM "coverage does not apply to bodily injury to an insured if the insured or his legal representative has made a settlement or has been awarded a judgment of his claim without our prior written consent."[336]

The Moon Court first considered the validity of the consent-to-settle clause. It held that "consent-to-settle provisions do not necessarily violate either the letter or the spirit" of the motor vehicle insurance statute.[337] However, a consent-to-settle clause, in the court's view, "does not . . . give a UIM insurance carrier carte blanche to deny UIM benefits to an insured victim."[338] Because insurers are required to act in good faith in dealing with their insureds, the court held that "a UIM carrier's grounds for denying UIM benefits under a

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[329] 90 Haw. 302, 978 P.2d 740 (1999).
[330] *Id.* at 304, 978 P.2d at 742.
[331] *Id.*
[332] *Id.*
[333] *Id.*
[334] *Id.*
[335] *Id.*
[336] *Id.* (emphasis removed).
[337] *Id.* at 309, 978 P.2d at 747.
[338] *Id.*

consent-to-settle provision in a UIM policy must be *reasonable*, in good faith, and within the bounds of the intent underlying HRS § 431:10C-301(b)(4)."[339]

Protection of the UIM carrier's subrogation right, the Moon Court noted, is a "reasonable basis for a refusal to consent to settlement."[340] Indeed, "the sole function of the consent-to-settle clause is the preservation of the subrogation right."[341] Because the UIM carrier that pays benefits "succeeds to the insured's rights against the tortfeasor," the UIM carrier may decide to pursue the tortfeasor if he or she "has sufficient assets to offset his or her lack of insurance."[342] Thus, consent-to-settle clauses serve the salient function of protecting the UIM insurer's subrogation rights.[343] The subrogation right, however, does not give the UIM carrier the right to block a liability settlement "on the unsupported assertion that it is doing so in order to protect its subrogation interests."[344] Rather, the UIM insurer must show "prejudice from the insured's failure to obtain the insurer's consent before settling with the tortfeasor."[345] Put another way, "'[i]f the carrier denies the claim of its insured *without a good faith investigation* into its merits, or if the carrier does not conduct its investigation in a reasonable time,' . . . the carrier may not deny UIM benefits to its insured."[346] In order to assess its subrogation prospects, the UIM carrier should investigate "the amount of assets held by the tortfeasor, the likelihood of recovery via subrogation, and the expenses and risks of litigating the insured's cause of action."[347]

The Moon Court then addressed the practical problem that the tortfeasor's liability insurer would unlikely agree to any settlement that does not include a general release. Such a general release, however, would prejudice the UIM carrier, whose rights, being no greater than the rights of the claimant, would then be precluded from pursuing its subrogation claim against a released tortfeasor. To address this conundrum, the Moon Court held that

> an underinsured tortfeasor's automobile insurance carrier discharges its duty to indemnify its insured when, as a condition of a good faith settlement, it provides its insured with the protection of an agreement in which the victim releases the

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[339] *Id.* (emphasis in original). Hawai'i Revised Statutes section 431:10C-301(b)(4), to which the court referred, is the statute that defines UIM insurance in the motor vehicle insurance law. *See* HAW. REV. STAT. § 431:10C-301(b)(4) (2005).

[340] *Taylor*, 90 Haw. at 310, 978 P.2d at 748.

[341] *Id.* (quoting Longworth v. Van Houten, 538 A.2d 414, 419 (N.J. 1988)).

[342] *Id.*

[343] *Id.*

[344] *Id.* at 311, 978 P.2d at 749.

[345] *Id.*

[346] *Id.* (emphasis in original; citation omitted).

[347] *Id.* (quoting Gibson v. State Farm Mut. Auto. Ins. Co., 704 N.E.2d 1, 6 (Ohio App. 1997)).

> tortfeasor from all personal claims but preserves the UIM carrier's right of subrogation.[348]

The Moon Court then turned to examine the exhaustion clause, which "requires the insured [to] settle with or obtain judgment against the tortfeasor in the full amount of the tortfeasor's own liability coverage before the UIM carrier has any payment obligations at all under the UIM coverage."[349] One effect of an exhaustion clause, the court explained, is that:

> the tortfeasor's carrier, by offering to settle for a sum somewhat less than the policy limits, can force the victim to trial solely in order to protect his UIM claim. In effect[,] then, the victim is denied the perfectly reasonable choice of saving months, if not years, of delay, trial preparation expenses, and all the ensuing wear and tear by simply accepting the offer and, as a condition of proceeding with his UIM claim, foregoing the difference between the tortfeasor's policy limit and the tortfeasor's insurer's offer.[350]

In light of these deleterious consequences of enforcing the exhaustion clause, the Moon Court held that "[w]here the best settlement available is less than the defendant's liability limits, the insured should not be forced to forego the settlement and [go] to trial in order to determine the issue of damages."[351] Importantly, however, if the plaintiff "does accept less than the tortfeasor's policy limits, his recovery against his UIM carrier must nevertheless be based on a deduction of the full policy limits."[352]

Seven years later, the Moon Court had occasion to provide more guidance to UIM insurers, insureds, and insurance law practitioners in cases where the bodily injury liability carrier offers settlement in an amount less than the policy limits. In *Granger v. Government Employees Insurance Co.*, Margaret Granger

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[348] *Id.* at 311-12, 978 P.2d at 749-50.

[349] *Id.* at 313, 978 P.2d at 751.

[350] *Id.* Under Hawai'i law, a liability insurer for a tortfeasor has no duty to negotiate a settlement in good faith with a plaintiff. Simmons v. Puu, 105 Haw. 112, 121, 94 P.3d 667, 676 (2004) (quoting Long v. McAllister, 319 N.W.2d 256, 262 (Iowa 1982)). *But see* Young v. Allstate Ins. Co., 119 Haw. 403, 426, 198 P.3d 666, 689 (2008) (holding that a plaintiff in an underlying lawsuit may assert a claim of intentional infliction of emotional distress against the third-party liability insurer of the tortfeasor in the underlying lawsuit for "conduct during the litigation" that caused the plaintiff to experience severe anxiety, worry, fear, and mental and emotional distress).

[351] *Taylor*, 90 Haw. at 313, 978 P.2d at 751 (quoting Schmidt v. Clothier, 338 N.W.2d 256, 260-61 (Minn. 1983)).

[352] *Id.* (quoting Longworth v. Van Houten, 538 A.2d 414, 423 (N.J. 1988)). In a concurring opinion, Justice Paula Nakayama admonished that the result of this case, i.e., the part permitting UIM claims to be asserted where the underlying settlement requires payment of less than the full liability limits, should not be construed by liability insurers "as carte blanche to offer lower settlements without good faith justification." *Id.* at 315, 978 P.2d at 753 (Nakayama, J., concurring).

was injured in a motor vehicle accident involving Jane Chong.[353] Granger was insured under a UIM policy issued by GEICO, and Chong was insured under an auto liability policy, with a liability limit of $100,000.00, issued by USAA.[354] After Granger filed suit against Chong, the parties agreed to a settlement under which USAA, on behalf of Chong, would pay $90,000.00.[355] Before finalizing the settlement, Granger wrote to GEICO, her UIM carrier, requesting GEICO's consent to the settlement with Chong and advising GEICO that she would be pursuing a UIM claim.[356] GEICO responded that it could neither refuse to consent nor consent to waive its subrogation right at that time; instead, it requested additional information regarding Chong's asset information, potential excess liability coverage available to Chong, and identity of other UIM carriers applicable to the loss.[357]

After conducting its investigation, GEICO advised Granger that its UIM subrogation right "appears viable," that GEICO therefore cannot consent to any bodily injury liability settlement that fully releases Chong's parents from GEICO's subrogation rights, and that it was requesting additional asset information from Chong's mother.[358] Alternatively, GEICO proposed that USAA and Granger could enter into a "*Taylor* release."[359] Chong (perhaps through her liability carrier, USAA) balked at the proposal, indicating that the settlement proposal would be withdrawn if the release provides "anything less than a full release" by Granger.[360] Granger then demanded that GEICO advance her the $90,000 that Chong (through USAA) had offered in exchange for a settlement of the liability claim.[361]

The Moon Court adopted the rule of at least eighteen jurisdictions that "after the UIM insurer has a reasonable opportunity to consider the implications of a pending settlement, it must either allow the settlement to proceed or tender to its insured a payment equal to the tortfeasor's settlement offer (up to the limits

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[353] 111 Haw. 160, 162, 140 P.3d 393, 395 (2006).

[354] *Id.*

[355] *Id.* at 163, 140 P.3d at 396.

[356] *Id.*

[357] *Id.* at 162, 140 P.3d at 395.

[358] *Id.*

[359] *Id.* The term "*Taylor* release" referred to the kind of release approved by the Moon Court in *Taylor*, whereby "the victim releases the tortfeasor from all personal claims but preserves the UIM carrier's right of subrogation." Taylor v. Gov't Emps. Ins. Co., 90 Haw. 302, 312, 978 P.2d 740, 750 (1999).

[360] Granger, 111 Haw. at 162, 140 P.3d at 395. This stalemate highlighted the practical dilemma posed by the "*Taylor* release"—how does a third-party liability insurer satisfy its obligations toward its insured if it agrees to a partial release that preserves the right of a UIM carrier to pursue subrogation claims against the insured tortfeasor?

[361] *Id.*

of the insured's UIM coverage)."[362] The court then adopted the Alabama Supreme Court's procedural guidelines for UIM claimants and their insurer in the event the claimant enters into a proposed settlement with the tortfeasor's liability carrier: (1) before finalizing the settlement, the claimant should immediately notify the UIM carrier of the proposed settlement terms; (2) the claimant should notify the UIM carrier if he or she intends to assert a UIM claim in addition to the liability settlement so the UIM carrier can determine whether it will "refuse to consent to the settlement, will waive its right of subrogation against the tortfeasor, or will deny any obligation to pay [UIM] benefits;[363] and (3) the UIM carrier should immediately investigate the claim, conclude its investigation within a reasonable period of time, and notice the UIM insured of its intended action.[364] "The insured should not settle with the tort-feasor without first allowing the [UIM] insurance carrier a reasonable time within which to investigate the insured's claim and to notify its insured of its proposed action."[365] However, if the UIM carrier "*wants to protect its subrogation rights, it must, within a reasonable time*, and, in any event before the tort-feasor is released by the carrier's insured, *advance to its insured an amount equal to the tort-feasor's settlement offer*."[366]

The *Taylor* and *Granger* decisions reasonably balanced the interests of UIM insureds and insurers in situations where, for valid reasons or not, bodily injury liability carriers refuse to contribute the entire underlying liability policy limits toward a settlement. On the one hand, the insureds' interests are protected by

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[362] *Id.* at 166, 140 P.3d at 399.

[363] Lambert v. State Farm Mut. Auto. Ins. Co., 576 So. 2d 160, 167 (Ala. 1991). This step in the Alabama Supreme Court's procedure—which the *Granger* court apparently adopted—includes two elements that appear to be at odds with dicta in *Taylor*. First, the Alabama approach appears to require the UIM claimant to notify the UIM carrier about the proposed settlement even if the claimant does not intend to assert a UIM claim. *Id.* This is contrary to the statement in *Taylor* that "an insured party who does not file a claim under his or her UIM policy is under no obligation to obtain the consent of his or her UIM insurer as a precondition to a settlement with the relevant tortfeasor or tortfeasors." *Taylor*, 90 Haw. at 309 n.5, 978 P.2d at 747 n.5. Nevertheless, if the Alabama notice requirement is construed as precautionary—as claimants may later decide to assert a UIM claim provided such a claim is still timely—then the *Taylor* dicta and Alabama element are consistent.

Second, the Alabama approach seemingly allows the UIM carrier to decide to "deny any obligation to pay [UIM] benefits." *Lambert*, 576 So. 2d at 167. However, as the *Taylor* court stated, "it would not be reasonable for a UIM carrier to deny UIM benefits under a consent-to-settle provision because it believed that the plaintiff had not actually sustained damages, or because it believed that the tortfeasor was not underinsured. These are issues that may be decided by arbitration, pursuant to the provisions of the UIM policy." *Taylor*, 90 Haw. at 314 n.11, 978 P.2d at 752 n.11.

[364] *Lambert*, 576 So. 2d at 167.

[365] *Granger*, 111 Haw. at 167, 140 P.3d at 400 (quoting *Lambert*, 576 So. 2d at 167).

[366] *Id.* (quoting *Lambert*, 576 So. 2d at 167) (emphases in original).

Taylor's invalidation of the exhaustion clause. On the other hand, the UIM insurers' interests are protected by *Taylor*'s enforcement of the consent-to-settle clause in order to protect the UIM insurers' right under *Granger* to investigate and decide, within a reasonable period of time, whether to advance the proposed bodily injury liability settlement to the UIM insured and to pursue the subrogation claim against the underinsured motorist. These two cases represent a fortunate confluence of the legal and practical aspects of handling UIM claims in Hawai'i.

What followed in 2007 was the third of the trilogy of UIM cases dealing with the consent-to-settle provision and its impact on proposed bodily injury liability settlements. In *Zane v. Liberty Mutual Fire Insurance Co.*, Dawna Zane was a passenger in a Dodge Neon manufactured by DaimlerChrysler, driven by Richard Thomas, and insured under both bodily injury liability and UIM coverages by Liberty Mutual.[367] The Neon and another vehicle, operated by Sarah Kim and insured by State Farm, collided at an intersection, rendering Zane a paraplegic.[368] Zane filed suit against Thomas, Kim, and DaimlerChrysler, the latter under products liability theories.[369] Through mediation, the parties in the lawsuit reached a settlement under which DaimlerChrysler agreed to contribute $200,000,[370] Kim agreed to pay her liability limit of $100,000, and Thomas promised to pay his liability limit of $1,350,000.[371] Zane's parents' insurer, AIG Hawai'i, agreed to pay Zane $40,000.[372] Although Zane recovered a total of $1,690,000, the parties agreed that the value of her claim exceeded that compromised figure.[373]

Thereafter, Zane asserted a UIM claim under the Liberty Mutual policy.[374] The parties agreed that Liberty Mutual initially accepted coverage, but then refused to tender the UIM benefits on the ground that Kim, the underinsured motorist from Zane's perspective, was not negligent.[375] In addition, the parties agreed that Liberty Mutual "gave prior consent to the act of settling with DaimlerChrysler and its codefendants, but disagree as to whether Liberty Mutual also represented to Zane that it understood and either agreed or did not

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[367] 115 Haw. 60, 64, 165 P.3d 961, 965 (2007).

[368] *Id.*

[369] *Id.*

[370] *Id.*

[371] *Id.*

[372] *Id.*

[373] *Id.* Although the court characterized this $40,000 payment by AIG Hawai'i as a bodily injury liability payment, it may have been made pursuant to a UIM policy issued to Zane's parents and under which Zane qualified as a class one insured. It does not appear that either Zane or her parents would have been liable for Zane's injuries such that liability coverage would have been triggered under the AIG Hawai'i policy. *Id.* at 64 n.3, 165 P.3d at 965 n.3.

[374] *Id.* at 65, 165 P.3d at 966.

[375] *Id.*

dispute that DaimlerChrysler's limitless self-insurance would be excluded from the calculation of the *Taylor* 'gap.'"[376]

The Moon Court ruled that there were genuine issues of material fact as to the nature of Liberty Mutual's representations to Zane's attorneys regarding the *Taylor* gap and as to whether Liberty Mutual should be estopped from arguing that gap in the lawsuit and on appeal; accordingly, the case was remanded for further proceedings.[377] The Moon Court also addressed Zane's argument that the DaimlerChrysler settlement should not be used to compute the *Taylor* gap because that gap applies only to liable parties and because DaimlerChrysler, "having settled for what the parties agree was nuisance value rather than a liquidation of 'actual' fault, was not a tortfeasor for purposes of the *Taylor* rule."[378] In rejecting Zane's argument, the Moon Court provided the following guidance:

> We believe that the choice of whether or not to settle with any particular defendant, with its consequent benefits and detriments, remains with the plaintiff even when discovery is fruitless. We disagree with Zane's implication that adjudication, arbitration, or admission of fault is a precondition of a *Taylor* offset. We agree with Liberty Mutual that, where a UIM insured has settled with an alleged tortfeasor, the UIM insurer is not barred from discounting its financial responsibility for its insured's damages merely because the insured asserts that the defendant was not liable, regardless of (1) the defendant's "negligible" settlement amount and/or (2) the UIM insurer's consent to the *mere act of settling* (holding aside the estoppel controversy).
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> . . . [W]e believe that a plaintiff/UIM insured who names a defendant and retains the defendant in the suit all the way to settlement assumes both the potential benefit of a defendant's ample insurance and the risk that the defendant's [bodily injury liability] limit may far exceed the feasible settlement value; a defendant's settlement alone does not extinguish its "tortfeasor" status for purposes of offsetting a UIM claim.[379]

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[376] *Id.*

[377] *Id.* at 73, 76, 165 P.3d at 974, 977.

[378] *Id.* at 76, 165 P.3d at 977.

[379] *Id.* at 77, 165 P.3d at 978 (emphasis in original). As the Moon Court pointed out, Zane's argument that an actual adjudication is required for "tortfeasor" status is unavailing. In both *Taylor* and *Granger*, the tortfeasors were not adjudged to be liable, yet they were deemed "tortfeasors" for UIM purposes. *Id.* The Moon Court also relied upon a third case, *Government Employees Insurance Co. v. Dizol*, 176 F. Supp. 2d 1005 (D. Haw. 2001), in which the United States District Court for the District of Hawai'i followed *Taylor* and ruled that "amounts forgone in below[-]policy[-]limits settlement with joint tortfeasors without the UIM carrier's consent are properly used to offset the [UIM] carrier's liability." *Id.* at 1033. As the Moon Court pointed out, the *Dizol* court had also deemed the settling defendant to be a "joint tortfeasor" for UIM purposes without any formal adjudication of liability. *Zane*, 115 Haw. at

Importantly, the Moon Court pointed out that Zane raised on reconsideration an argument that DaimlerChrysler "was not an owner or operator of any vehicle, let alone an underinsured one."[380] At the heart of Zane's argument is that the motor vehicle insurance law requires UIM coverage for loss resulting from bodily injury sustained by any person "legally entitled to recover damages from *owners or operators* of underinsured motor vehicles."[381] Zane argued that "inasmuch as (1) she implicated DaimlerChrysler as a defendant upon a theory of products liability, and (2) DaimlerChrysler was not an owner or operator of a motor vehicle, DaimlerChrysler's funds 'have nothing to do with motor vehicle insurance.'"[382] The Moon Court ruled that Zane raised this argument too late and that it was "waived for purposes of this appeal"; but the Court noted that Zane was "free to raise it on remand."[383]

Unfortunately for the legal and insurance communities, an appellate resolution of Zane's new argument—that the *Taylor* gap is inapplicable to joint tortfeasors who are neither owners nor operators of underinsured motor vehicles—must wait another day. On its face, however, the argument finds support in the wording of the motor vehicle insurance statute, which requires UIM coverage to apply when an insured is "legally entitled to recover damages from *owners or operators* of underinsured motor vehicles."[384]

77, 165 P.3d at 978.

[380] *Zane*, 115 Haw. at 76, 165 P.3d at 977.

[381] HAW. REV. STAT. § 431:10C-301(b)(4) (2005) (emphasis added).

[382] *Zane*, 115 Haw. at 76, 165 P.3d at 977.

[383] *Id.*

[384] HAW. REV. STAT. § 431:10C-301(b)(4) (emphasis added). Notably, the statute does not require UIM coverage only when the accident, or, put another way, all tortfeasors, are underinsured. Moreover, the wording of the UIM endorsement available for use by insurers provides in part that "[i]f we make any payment and the 'insured' *recovers from another party*, the 'insured' shall hold the proceeds in trust for us and pay us back the amount we have paid." This condition in the UIM endorsement could be construed to apply to situations where the UIM policy pays, because an underinsured motorist is deemed at fault, in advance of a settlement or judgment against other joint tortfeasors.

In *AIG Hawaii Insurance Co. v. Rutledge*, 87 Haw. 337, 955 P.2d 1069 (App. 1998), a UM (rather than a UIM) policy issued by AIG Hawai'i included a similar condition, stating: "If [AIG] make[s] a payment under this policy and the person to or for whom payment is made recovers damages from another, that person shall hold in trust for us the proceeds of the recovery and shall reimburse us to the extent of our payment." *Id.* at 339, 955 P.2d at 1071.

The ICA, in a unanimous decision written by then-Judge Acoba, held that "when an insured motorist, who has received uninsured motorist (UM) benefits from his or her insurer as a result of a motor vehicle accident with an uninsured motorist, obtains a tort recovery from the uninsured motorist or a *party jointly liable* which fully compensates the insured for damages sustained in the accident, the insurer may enforce a policy provision requiring the insured motorist to reimburse the insurer for UM benefits paid." *Id.* at 338, 955 P.2d at 1070 (emphasis added).

As the foregoing demonstrates, the Moon Court actively adjudicated issues involving the motor vehicle insurance law that, while sometimes perplexing or frustrating, ultimately provides insurance law practitioners, insurers, insureds, and claimants with a better understanding of the law. The Moon Court broadly construed the definitions of "covered person" or "insureds" under automobile insurance policies; limited emotional distress claims that are derivative in nature to the "per person" limit of insurance applicable to the "host" injured plaintiff; and provided guidance in the settlement of UIM claims when the UIM carrier seeks to preserve its subrogation rights against the underinsured motorist and/or when the bodily injury liability carrier does not settle for its policy limit.

VII. CONCLUSION

The Moon Court years were active in insurance law. Chief Justice Moon and his colleagues on the court brought extensive prior judicial and practice experience in insurance to the decisions they rendered. Although these cases resolved important issues that were previously unanswered in Hawai'i, the court more often than not broke little new ground. Instead, the decisions involved weighing approaches developed elsewhere.

In examining the choices the court made, it is difficult to characterize the body of decisions as either "pro-insured" or "pro-insurer," either by a simple tally or by examining the underlying policies it articulated. For example, in *Sentinel* and in *Best Place*, cases generally helpful to insureds, the court declined to adopt rules that would penalize insurers who make reasonable but erroneous decisions to the detriment of insureds, even in cases where the insurer seemingly gambles on an outcome at the expense of its insured. On the other hand, in areas of coverage, as in *Sentinel* in the CGL area or *Dawes* in the auto cases, it adopted a broad view that favored insureds.

One cannot minimize how valuable it is in insurance cases just to have important issues resolved, because certainty reduces transaction costs and expedites resolution of claims. Certainly, attorneys welcomed *Finley* because it answered the fundamental question: "Who do I work for?" The cost of uncertainty in insurance law takes a toll on all parties. Regardless of whether any single case was rightly or wrongly decided, having answers proves to have its own value.