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Court Refuses to Enforce Escape Clause, Refuses to Grant Summary Judgment on Contractors Special Conditions Endorsement and Holds that Equitable Tolling Applies to Insurer Versus Insurer Contribution Actions

In *Underwriters of Interest v. ProBuilders Specialty Ins. Co.* (No. D066615; filed 10/23/15), a California appeals court refused to enforce an “escape” other insurance clause in an insurer versus insurer contribution action, refused to enforce a Contractors Special Conditions endorsement, and found that equitable tolling applied to rule that a nondefending insurer was obligated to reimburse defense costs incurred defending the two insurers’ common insured.

Certain Underwriters provided CGL insurance to Pacific Trades Construction & Development in effect between October 23, 2001 and October 23, 2003. ProBuilders Specialty insured Pacific Trades from December 9, 2002 to December 9, 2004. When Pacific Trades was sued in construction defect action arising out of the development and construction of single family homes, Underwriters provided a defense, while ProBuilders declined to participate. The case was ultimately settled and when Underwriters sued ProBuilders for contribution to the defense costs, the trial court granted summary judgment for ProBuilders, finding its other insurance clause precluded any obligation to contribute or reimburse Underwriters.

The ProBuilders other insurance clause stated that ProBuilders had “the right and duty to defend [Pacific Trades] against any suit seeking . . . damages [to which the insurance applied] provided that no other insurance affording a defense against such a suit is available to you.” In addition, the ProBuilders policy attached a Contractors Special Conditions (“CSC”) endorsement that provided, as a “condition precedent to this policy applying to any claim in whole or in part based upon work performed by independent contractors,” Pacific Trades must have: (1) obtained valid written indemnity agreements from the subcontractors it hired to build the homes, and (2) obtained Certificates of

Insurance from the subcontractors it hired showing Pacific Trades was an additional insured under the subcontractors’ insurance policies, and (3) maintained records evidencing compliance with those obligations.

The appeals court held that the ProBuilders other insurance clause was a disfavored escape clause, saying “the courts have considered this type of ‘other insurance’ clause as an ‘escape’ clause, a clause which attempts to have coverage, paid for with the insured’s premiums, evaporate in the presence of other insurance. . . . Escape clauses are discouraged and generally not given effect in actions where the insurance company who paid the liability is seeking equitable contribution from the carrier who is seeking to avoid the risk it was paid to cover.” (Quoting *Edmondson Property Management v. Kwock* (2007) 156 Cal.App.4th 197, 203-204.) Among other things, the *ProBuilders* court noted that the two insurers’ policies provided overlapping, but not identical coverage, and to impose the duty to defend solely on Underwriters would have been forcing Underwriters to defend claims covered by ProBuilders but outside of Underwriters’ coverage. Consequently, the *ProBuilders* court refused to enforce the other insurance clause.

The appeals court also refused to find that the CSC endorsement excused ProBuilders from contributing to the defense. The court noted that the CSC provision applied only to claims against Pacific Trades “in whole or in part based on work performed by independent contractors,” but did not purport to apply to claims against Pacific Trades for its own negligence or other misfeasance. The court held that ProBuilders had not conclusively shown that all of the claims against Pacific Trades were limited to work performed by independent contractors and in fact there were allegations of Pacific Trades’ own negligence. Further, although there was evidence of incomplete compliance with the CSC requirements, the *ProBuilders* court found that evidence of only one subcontractor indemnity agreement or certificate of additional insured coverage was sufficient to preclude summary judgment in favor of ProBuilders.

The court also rejected ProBuilders' argument that Underwriters' contribution claim was time-barred. While agreeing that a two-year statute of limitations applies to an action by an insurer seeking equitable contribution from another insurer, and acknowledging that more than two years had elapsed since ProBuilders initially refused to contribute or participate in the defense, the court noted that less than two years had passed since the final settlement of the underlying action. Finding no California case law in point, the court cited *Lambert v. Commonwealth Land Title Ins. Co.* (1991) 53 Cal.3d 1072, which held that an insured's action against its own insurer is equitably tolled until the underlying action is terminated by final judgment. The *ProBuilders* court said there was no reason why the same rule should not apply to insurer versus insurer contribution actions, and several reasons why it should. For example, holding that the statute begins to run on a refusal to defend might force the defending insurer to file its contribution action prematurely, before all damages could be ascertained. That would require multiple amendments or filing of multiple actions as damages accrued and "[n]either scenario would promote judicial economy or the orderly resolution of claims." Thus, the *ProBuilders* court stated:

"We conclude *Lambert* is sufficiently analogous to require that we import the same approach into contribution actions among co-insurers. We hold the limitation period for a contribution action accrues when the noncontributing insurer first refuses the demand to contribute, but that the two-year statute of limitations is tolled until all of the defense obligations in the underlying action are terminated by final judgment in the underlying action."

Finally, the *ProBuilders* court refused to agree that Underwriters' alleged refusal to produce the defense bills during discovery supported summary judgment for ProBuilders. The court said that summary judgment was not an alternative to seeking terminating sanctions: "We conclude ProBuilders' remedy, if any, for Underwriters' alleged 'refusal' to

produce certain documents is to pursue the discovery statutes' incremental approach to discovery sanctions."

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Oregon's Lack of Compulsory Counterclaims

When a defendant has potential claims against a plaintiff based on the same events in the plaintiff's suit, many states and the federal system require that the defendant raise those claims in the same suit. In these jurisdictions, if the defendant does not counterclaim, then it will be barred from subsequently raising those claims. This requirement to raise or else waive creates a "compulsory" counterclaim requirement. However, Oregon does not have compulsory counterclaims. Compare Fed. R. Civ. Proc. 13(a) (requiring parties to bring certain counterclaims) with Or. R. Civ. Proc. 22 A (permitting but not requiring counterclaims). If defendants in Oregon have potential claims against plaintiffs, they generally are not precluded from bringing their claims as plaintiffs in a separate action. Though there are exceptions to this general rule, understanding Oregon's approach to counterclaims and preclusion adds strategic considerations when being sued.

In federal court, counterclaims are compulsory when the claim arises out of the same transaction or occurrence. Fed. R. Civ. Proc. 13(a). Thus, a defendant in one case must counterclaim against the plaintiff for all claims relating to the same transaction or occurrence. Failing to do so will result in precluding defendant's claim against that plaintiff. E.g. *Southern Construction Co. v. Pickard*, 371 U.S. 57 (1962). In contrast, Oregon allows a defendant in the first case to raise its claims as a plaintiff in a second case. *Buck v. Mueller*, 221 Or. 271, 277, 351 P.2d 61 (1960). Once a claim is raised, Oregon tracks federal law, and all claims related to the same transaction or occurrence must be raised. *G.B. v. Morey*, 229 Or. App. 605, 608-09, 215 P.3d 879 (2009).

Important Caveats

There are two exceptions in Oregon to a defendant's ability to raise its claims in a subsequent case. First, the defendant in the first case is precluded from bringing a subsequent case as a plaintiff if the first case "necessarily adjudicated" the claim. *Id.* at 609. Second, a defendant who actually raises a counterclaim or otherwise seeks affirmative relief in the first case is precluded from seeking relief as a plaintiff in a subsequent case. *Id.*

The first exception of "necessarily adjudicating" the claim applies in situations where the factual and legal issues were actually litigated and essential to the outcome. *Ram Technical Services, Inc. v. Koresko*, 240 Or. App. 620, 632, 247 P.3d 1251 (2011). For instance, in a negligence action, a verdict apportioning fault between the plaintiff and defendant "necessarily adjudicated" any subsequent claim that the defendant may have against the plaintiff for negligence. If, however, there was a settlement of plaintiff's negligence claims, and there was no actual litigation, the defendant may subsequently bring suit as long as it does not violate the settlement agreement or fall within the second exception.

The second exception of seeking affirmative relief in the first case prevents a defendant from counterclaiming against a plaintiff and then subsequently bring suit against that plaintiff. Since Oregon preclusion rules apply to claims, counterclaims, crossclaims, or third-party claims between the same parties, once a defendant asserts affirmative relief, the defendant must bring all claims for affirmative relief relating to the same transaction or occurrence. *See* Or. R. Civ. Proc. 54 D(2). However, if a defendant does not assert a claim for affirmative relief, and if that claim was not necessarily adjudicated under the first exception, then the defendant may bring its claim in a later action.

Strategic Considerations

Not pursuing counterclaims still allows the defendant to pursue those claims in the future as long as the first case does not necessarily adjudicate the claim and the defendant did not otherwise seek

affirmative relief. Litigating the first case does not toll the statute of limitations, so suit must still be brought in time. If the plaintiff filed suit near the end of the limitations period, then waiting to bring suit is not a practical option. Additionally, if the suit is based on negligence and the plaintiff was partially at fault, then adjudication at trial will bar a separate suit because the issue of negligence would have been litigated and decided. Not litigating the counterclaim may keep expenses lower, especially if the counterclaim involves only tangentially related issues. However, having a viable counterclaim may be useful leverage against the plaintiff in settlement negotiations. Thus, saving costs of litigating the counterclaim (without foreclosing the option to pursue it in the future) must be balanced against the counterclaim's impact on reducing the plaintiff's damages.

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Coverage for Blast Fax Cases Under Cyber Liability Coverage

For some time, courts have been dealing with the question of whether there is coverage for violations of the Telephone Consumer Protection Act ("TCPA"), 47 U.S.C. § 227 *et seq.*, which imposes statutory penalties of \$500 for sending unsolicited faxes, under the standard Commercial General Liability ("CGL") coverage. For the most part, this has been determined, with courts generally finding that there is personal injury coverage under a CGL policy as a violation of a person's right of privacy. *E.g., Valley Forge Ins. Co. v. Swiderski Elecs., Inc.*, 223 Ill. 2d 352 (2006); *Terra Nova Ins. Co. v. Fray-Witzer*, 449 Mass. 406, 869 N.E.2d 565, 573 (2007) (New Jersey law); *Penzler v. Transp. Ins. Co.*, 29 So. 3d 1000, 1007 (Fla. 2010). As a result, most CGL policies now include an endorsement that specifically excludes coverage for TCPA claims, and these exclusions have been upheld. *E.g., In G.M. Sign, Inc. v. State Farm Fire & Cas. Co.*, 2014 IL App (2d) 130593 (Ill. Ct. App. 2014); *Creative Hospitality Ventures, Inc. v. United States Liab. Ins. Co.*, 655 F. Supp. 2d 1316 (S.D. Fla. 2009).

Class action plaintiff attorneys are not easily deterred. Faced with increasing difficulty recovering under CGL coverages, they have sought to find coverage under other types of policies. This has intersected with the new demand by businesses for protection for their risk from network and internet security breaches, and the insurance industry's response to this demand by offering various forms of cyber liability coverage. In *Doctors Direct Ins. Inc. v. Bochenek*, 2015 IL App (1st) 142919, the plaintiffs found that their quest for new coverage may be an uphill battle.

The class plaintiffs in *Doctors Direct* sued a plastic surgeon for sending out blast text messages advertising Botox and other cosmetic surgery services in violation of the TCPA and in violation of the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/2. The plastic surgeon filed a petition for bankruptcy, and the bankruptcy court entered an order limiting any recovery against the plastic surgeon to the proceeds of an insurance policy issued by Doctors Direct.

In addition to standard medical professional liability coverage, the Doctors Direct policy also provided coverage for a cyber claim resulting from any "Network Security Wrongful Act" or any "Privacy Wrongful Act." The policy defined "Privacy Wrongful Act" as:

[A]ny breach or violation of U.S. federal, state, or local statutes and regulations associated with the control and use of personally identifiable financial, credit or medical information, whether actual or alleged, but only if committed by protected parties.

2015 IL App (1st) 142919, ¶6.

The plaintiff asserted that the TCPA and Consumer Fraud claims both fell within this coverage because the alleged conduct involved the control and use of personally identifiable financial, credit, and medical information. Additionally, the plaintiff alleged that discovery had revealed that the physician had acquired customer information, including names and cell phone numbers, from the owner of a spa, and

being identified as someone who might consume cosmetic surgery was stigmatizing so his actions implicated privacy concerns. The plaintiff further asserted that a list of people believed to be prospects for medical procedures was personally identifiable financial, credit, or medical information. *Id.* ¶12.

The court rejected the plaintiff's attempts to fit a TCPA claim within the ambit of the policy's definition of Privacy Wrongful Act. The court read the definition of Privacy Wrongful Act to require that the statute violated had to be "associated with" the control and use of personally identifiable financial, credit, or medical information. *Id.* ¶26. The court explained that the phrase immediately preceding "associated with" was "U.S. federal, state or local statutes or regulations." Therefore, the term "associated with" "only applies to 'U.S. federal, state or local statutes or regulations,' and not to 'any breach or violation.'" *Id.*

The court interpreted the term "associated with" to mean joined, combined, united, or connected with, and found that the TCPA was not joined, combined, united, or connected with the use of personally identifiable financial, credit, or medical information. As the court explained, "the statute only prohibits the actual making of certain kinds of calls. The statute does not address how a caller might control or use personally identifiable financial, credit, or medical information either before or after the call is made." *Id.* ¶29. Therefore, the court rejected the contention that the TCPA addressed the manner in which people were selected for marketing. *Id.* at ¶30.

Nor was the court persuaded that the Illinois Consumer Fraud Act was "associated with" the use of personally identifiable financial, credit, or medical information. Section 2 of the Consumer Fraud Act prohibits "[u]nfair methods of competition and unfair or deceptive acts or practices, including * * * the use or employment of any deception, fraud, false pretense, false promise, misrepresentation or the concealment, suppression, or omission of any material fact" with the intention that someone rely on that concealment, suppression or omission. 815 ILCS 505/2. The Act also prohibits the knowing violation of other statutes, such as the Automatic Telephone Dialers act, 815 ILCS 305/1, the Telephone Solicitations Act, 815 ILCS 413.1, and others. Under

the Consumer Fraud Act, a party may recover for unfair as well as deceptive conduct. 2015 IL App (1st) 142919, ¶34.

Considering all of this, the court concluded that “nothing in the plain language of the Consumer Fraud Act itself suggest that the statute is associated with personally identifiable financial, credit, or medical information.” *Id.* ¶35. The fact that the statute established practices offensive to public policy did not help the plaintiff, because it still did not establish that it was associated with the use of personally identifiable information.

While different cyber liability policies are likely to use varying language to define their coverage, the decision in *Doctors Direct* suggests that it will be difficult for plaintiffs to fit TCPA claims within the scope of this coverage.

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Increasing Risk of Bad Faith Failure to Settle Claims in Colorado

Increasingly, the plaintiffs’ bar in Colorado is sending time-limited policy limits demands directly to carriers within a very short time after the loss. Frequently, there is no pending litigation against the insured, and the carrier has had little, if any, opportunity to investigate. Often, this is the very first communication with the claimant. This is fast becoming a common strategy to enable claimants to pursue carriers for bad faith.

If a carrier does not respond and pay the demand within the designated time, claimants will negotiate what is known as a Bashor or Nunn agreement in Colorado, whereby the insured will agree to entry of judgment against him/her and assign all their policy and extracontractual claims to the claimant in consideration for a covenant not to execute against the insured; the damages amount is usually determined by an arbitration which is uncontested

by the insured. As you might expect, the resulting damages awards are usually quite high.

While Bashor agreements have been approved by Colorado courts for decades, what is different is who is making the demand. Historically, time-limited demands for a settlement within policy limits was made well into litigation, after discovery and after the parties have each had an opportunity to learn and vet the claims. Frequently, the ‘hammer letter’ would come from the insured’s personal counsel with a demand that the carrier protect the insured. Now, plaintiffs’ counsel are sending these letters out within a few weeks of a loss, often before any litigation has even been filed against the insured.

These letters may be simple form letters in which in a few short sentences the claimant notifies the carrier of the loss, asks for details (such as limits) on the policy, and makes a time limited demand for those limits. It is easy to underestimate the potential exposure posed by such a letter; this is particularly true when the loss is recent and no investigation has yet been conducted or completed. But beware, and make sure you take the steps necessary to protect yourself.

Make sure you respond in some way within the time allotted. If more time is needed, request the additional time, explaining that you are not in a position to evaluate the demand at that time. Communicate with your insured, notifying them of the demand and the current inability to respond and requesting information needed to complete your investigation. Document your file, including why you are not in a position to respond to the demand. Finally, be sure to prioritize this and do not assume that this ‘form letter’ has no teeth or that you will have a future opportunity to settle the claim; you may not.

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Members & Clients

UPCOMING DATES & NEWS

SAVE THE DATE! The ALFA International EPLI Conference is **June 8-10, 2016**. We hope to see you there!