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**Fighting Nice: Carrier vs. Carrier Disputes**

## I. Current Construction Defect Claims Issues from the Frontline

Construction defect claims and coverage issues arise in a number of circumstances and contexts. Here, we review certain issues that have become more prevalent and dominant in the defense and indemnity of named and additional insureds.

### A. Named and Additional Insured Coverage Issues

Most commercial general liability policies issued to contractors include an agreement by the insurer to defend the insured and states the insurer's right to appoint counsel to defend the insured. Typically, when an insured has tendered a covered suit to the insurer, the insurer has an immediate duty to defend the insured against the claims stated in that suit. In the absence of a conflict (Cumis or otherwise), the insurer has the exclusive right to appoint counsel to fulfill this promise to defend under the policy. Standard ISO CGL language provides:

> **SECTION I – COVERAGES**
> **COVERAGE A BODILY INJURY AND PROPERTY DAMAGE LIABILITY**
>
> **1. Insuring Agreement**
> a. We will pay those sums that the insured becomes legally obligated to pay as damages because "bodily injury" or "property damage" to which this insurance applies. <u>We will have the right and duty to defend the insured against any "suit" seeking those damages.</u> However, we will have no duty to defend the insured against "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "suit" that may result… [CG 00 01 12 07]

One major issue that has come up recently is presented in the co-carrier context where multiple carriers insure a mutual insured under CGL policies issued for different time periods. At the initial tender stage, carriers accepting the defense often push the non-participating carrier(s) to defend, assuming there is not a good reason to decline coverage. The goal in pushing the non-participating carrier is twofold: (1) the non-participating carrier may be the only carrier whose policy is exposed to an established indemnity obligation (i.e., it is clear that covered

"property damage" likely started in that carrier's policy period); and (2) the defense fee expense can be shared among the participating carriers.

What happens when a carrier decides to forego the sharing of a defense and instead appoints its own counsel to defend? Many carriers take this route when they might not be familiar with the currently appointed counsel and are more comfortable with their own panel counsel. It could also be that a participating carrier might seek at some point to withdraw from the defense; thus, having separate appointed counsel can make that withdrawal easier.

No matter what the reason, however, disputes arise when multiple defense attorneys are appointed to defend a single insured, creating conflict in the defense and/or the separation of defense responsibilities; or the separately appointed counsel doesn't do much in the way of defending the insured, placing the burden (and expense) onto another carrier.

With respect to indemnity issues, conflicts almost always arise in the situation of who pays what and why. In a co-carrier situation, primary carriers might disclaim actual indemnity coverage based on the facts of when a project was complete, or whether property damage occurred before or after the policy period, or the applicability of a custom endorsement, or a fair time on risk allocation. Some of these coverage positions are raised in the reservation of rights letter and are usually not the subject of heated discussion until the carriers have to work together to respond to a settlement demand made against the mutual insured.

Like the named insured context, in the additional insured context, there are a myriad of issues that arise when tender is made, and a defense is offered. These issues take on a similar form as in the above-described co-carrier context with a mutual insured. However, we have noticed a trend from participating AI carriers simply accepting an allocated portion of the defense based on the number of participating carriers, to the appointment of separate counsel (assuming no conflict). Other major issues include the differing scope of additional insured coverage available under each of the participating carrier's endorsements, the presence or absence of contractual defense and indemnity rights against the named insured, and of course priority of coverage.

## II. Resolution Strategies

### A. Know What You Don't Know Early On

Critical to the efficient and productive resolution process is to know what you don't know. Many times, carriers will accept (or deny) an insured's tender but will fail to let the other tendered carriers know their coverage position. A good first step in determining whether there will be a problem down the road is to inquire and to seek copies of the carrier's policy or policies and at minimum, the declination of coverage or reservation of rights letter. It is better to be prepared earlier than later as to what position the carrier might take when the liability claim is being prepared for settlement.

B. Pre-Mediation/ADR Discussion

Most complex (or even basic) construction defect cases will undergo multiple rounds of mediation sessions. Many mediators, however, are hesitant to become involved in coverage issue disputes and often tell the carriers (and their coverage counsel) to "figure it out".

It can be a good idea to meet, either in person or (more likely) by telephone, to discuss an appropriate allocation scenario in the event of a reasonable demand by plaintiff to settle the insured's liability. Written communication can be sufficient to express the carrier's position, but at the end of the day a telephone call can achieve much more than a letter writing campaign. It can also save the carrier money on paying coverage counsel to fight.

In those instances where an agreement before mediation/ADR cannot be reached, there are a number of resolution strategies including seeking a coverage mediation or other alternative dispute resolution process in order to try to reach resolution. The liability claim mediator can make suggestions as to a good mediator for the coverage dispute (although, ideally, a great mediator could do both). The advantage of this route is that ultimately it saves the parties time and expense in fighting in the courts. It also avoids the fight at the liability claim resolution session where, depending on the laws of the state, an insured can make an argument that the carriers' refusal to participate in settlement is bad faith because the carriers are placing their own interests (paying what is fair under the coverage landscape) over the interests of the insured in being removed from harm's way.

Other resolution strategies include an agreement to disagree. That is, the carriers might accept an allocation proposal but agree to dispute the allocation after the claim settles. This scenario can sometimes punish the "good" carrier who is more intent on settlement of the claims against the insured than in disputing the coverage aspects of the claim. In these situations, it also possible to elicit participation by the insured or the insured's personal counsel, to help in reaching an agreement and to bring a recalcitrant insurer back to the table.

C. Declaratory Judgment

A declaratory judgment action, whether filed in federal court under the discretionary power of 28 U.S.C. §§ 2201, 2202 or in state court, aims to declare the rights and other legal relations of the parties. The Declaratory Judgment Act provides that a district court "may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. 28 U.S.C. § 2201(a). District courts have broad "discretion to dismiss a federal declaratory judgment action when 'the questions in controversy…can better be settled in' a pending state court proceeding." *R.R. St. v. Transp. Ins.* Co. 656 F.3d 966, 975 (9th Cir. 2011) (quoting *Brillhart v. Excess Ins. Co.* 316 U.S. 491, 495 (1942)).

The Declaratory Judgment Act requires that an actual controversy exist in an action for declaratory relief. 28. U.S.C. § 2201(a). In the absence of an actual controversy, a district court is without justification to render declaratory relief. See, *Maryland Casualty Co. v. Pacific Coal & Oil Co*., 312 U.S. 270, 272 (1942). In general, for a court to exercise jurisdiction under the Declaratory Judgment Act, there must be a "substantial controversy, between parties having adverse legal interest, of sufficient immediacy and reality," *Maryland Casualty*, 312 U.S. at 273, which has "crystallized to the point that there is a specific need" for a declaratory judgment. *J.N.S. Inc. v. Indiana*, 712 F.2d 303, 305 (7th Cir. 1983).

Declaratory judgment actions are used to settle uncertainties. A declaratory judgment action between an insurer and its policyholder is often brought following a declination of coverage and centers on whether a duty to defend is owed. Declaratory actions between an insurer and another insurer may be brought after settlement of the underlying liability action but can also be brought during the pendency of an underlying liability suit to establish issues that may be critical to an insurer's participation in settlement of the liability suit.

Declaratory judgment actions are most useful in resolving duty to defend issues; issues regarding policy exclusions; and priority of coverage issues. Before a declaratory judgment action is filed, careful consideration should be made as to whether the claim is ripe and therefore justiciable. For instance, an insurer can attempt to seek a duty to indemnify ruling before any indemnity has been paid, but an astute opposing counsel may move to dismiss this claim as premature.

It is possible to have a justiciable or actual controversy but have the court stay the declaratory action. The Declaratory Judgment Act allows the federal court, at its discretion, to adjudicate the parties' rights and obligations on a disputed matter, even if a claim for damages has not yet arisen. 28 U.S.C. §2201(a). A district court, however, is under no compulsion to exercise that jurisdiction. *Brillhart v. Excess Insurance Company of America*, 316 U.S. 491, 494 (1942). "In the declaratory judgment context, the normal principle that federal courts should adjudicate claims within their jurisdiction yields to considerations of practicality and wise judicial administration." *Wilton v. Seven Falls Co*., 515 US 277, 288 (1995). Where circumstances warrant, the district court is authorized either to dismiss or stay the declaratory relief proceeding. *Id*. at 283. One such circumstance is where a "parallel action" exists --- i.e., an underlying liability action pending in state court where overlapping factual questions are being determined.

## III. Further Resolution Strategies and Conclusion

The conduct of the parties will determine whether a coverage issue will be resolved easily or with great difficulty. Often times, combative conduct serves only to push the parties further into their corner of the ring. Under those circumstances, little to no resolution or agreement can be achieved. Developing an open mind to another carrier's position may be the difference between intractable fighting or playing nice.

Communication is also key to resolving carrier to carrier disputes. Early communication as soon as the tender is accepted (or rejected) can place all the carriers on notice of the coverage positions involved and to see what if anything might be a fight later on. Throughout the process of the claims handling, carriers should try to work together on providing a substantive and effective defense for the insured. The carriers should also try to find reasonable opportunities to settle the claim and the issues between them, to avoid needless and protracted litigation going forward.

If litigation is the only way forward, then consideration should be made as to whether the declaratory judgment action will result in a ruling that might come back to haunt the carrier or whether a position can be taken without harm to the industry.