Piercing Settlements and Judgments in Mixed Covered/Noncovered Claims

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Introduction

- The **duty to defend** requires a full defense whenever ***any*** claim is potentially covered, even if other claims are not.
- By contrast, the **duty to indemnify** obligates the insurer to pay ***only*** for covered liabilities.
- At the end of a case – whether through settlement or judgment – the insurer and insured must determine **which portions of the outcome are covered**.
- Failing to allocate or "pierce" a settlement or verdict can lead to **disputes** and even **forfeiture** of coverage for the insured or **unanticipated payment obligations** for the insurer.

Introduction

- To navigate mixed-claim litigation, insurers must take proactive steps to preserve their rights on coverage and apportionment. This may include:
  - **defending** under a reservation of rights,
  - **intervening** in the lawsuit to propose **special verdict questions**, or
  - explicitly **notifying** the insured of the need for an allocated verdict.

Introduction

- Insurers also face decisions about how to handle settlement **demands that encompass noncovered exposures** – whether to

  - contribute and seek **reimbursement** later, or

  - **refuse to pay** noncovered portions.

Introduction

- If a judgment is entered without differentiating covered from noncovered damages, courts will later have to **allocate** the award in a coverage action, often placing the **burden of proof** on the party seeking coverage.
- An insurer's mishandling of these issues (for example, a bad-faith failure to defend or settle) can **estop** the insurer from contesting coverage and render it liable for the entire judgment, including noncovered damages.

Introduction

- This presentation provides a high-level overview and examines these issues in detail for five jurisdictions:
  - Texas,
  - California,
  - New York,
  - Washington, and
  - Florida

Introduction

For each jurisdiction, we address six key questions:

1. Preserving Apportionment or Coverage Issues
2. Handling Noncovered Portions of Settlements
3. Handling Noncovered Portions of Judgments
4. Intervention in the Underlying Case
5. Special Jury Interrogatories
6. Post-Verdict Coverage Litigation

Introduction: Question 1

Preserving Apportionment or Coverage Issues:

What must an insurer do during the underlying case to preserve its right to later argue about apportionment or coverage when both covered and noncovered claims are in play?

Introduction: Question 2

Handling Noncovered Portions of Settlements:

How should an insurer handle a settlement that resolves both covered and noncovered claims – can it contribute to the settlement and later deny or recoup the noncovered portion?

Introduction: Question 3

Handling Noncovered Portions of Judgments:

How should an insurer handle a trial verdict/judgment that encompasses liability for both covered and noncovered claims?

Introduction: Question 4

Intervention in the Underlying Case:

Should an insurer ever intervene in the liability lawsuit to protect its interests when there are mixed covered and noncovered claims (for instance, to request special questions or affect the verdict form)?

Introduction: Question 5

Special Jury Interrogatories:

Should an insurer request that the jury be given special interrogatories or a special verdict form to separate covered from noncovered findings?

Introduction: Question 6

Post-Verdict Coverage Litigation:

In a declaratory judgment ("DJ") action after a mixed-claim settlement or judgment, what issues can the insurer litigate – for example, allocation of damages, applicability of exclusions, or reimbursement?

Topic 1: Preserving Apportionment or Coverage Issues

In most states, necessary steps may include:

- Issue a Reservation of Rights Letter
- Provide a Defense (Often Under Reservation)
- Avoid Conflicts of Interest
- Seek Declaratory Relief (Optional but Common)
- Track and Allocate Defense Costs

Topic 1: Preserving Apportionment or Coverage Issues

Illinois is a notable **outlier**. An insurer must either

(1) defend under a reservation of rights, or

(2) promptly file a declaratory judgment action

to preserve coverage issues.

Employers Insurance of Wausau v. Ehlco Liquidating Trust, 708 N.E.2d 1122 (Ill. 1999).

Topic 1: Preserving Apportionment or Coverage Issues

Views of the five states:

TX: ROR sufficient; post-verdict DJ allowed even if DTD breached

CA: Strict ROR preserves coverage issues *and* reimbursement

NY: No ROR = estoppel risk

WA: ROR required; conflict rules strict

FL: Must advise re special verdicts or risk burden shift

Topic 2: Handling Noncovered Portions of Settlements

Option	Description	Key Considerations
Reimbursement	Pay now, seek repayment for noncovered claims	Jurisdiction-dependent; most states require some sort of prior notice, an agreement or express policy language
Declaratory Judgment	Ask court to determine coverage post-settlement	Must act promptly to avoid estoppel. Must prove which claims were not covered; a shifting burden applies (insured's burden for insuring agreement; insurer's burden for exclusions; insured's burden for an exclusion's exception).
Deny Coverage	Refuse to indemnify for noncovered portion	Unilateral denials can risk bad faith exposure. A declaratory judgment action is often preferable.

Topic 2: Handling Noncovered Portions of Settlements

Views of the five states on **reimbursement**:

TX: No, absent policy language or agreement (*Matagorda*)

CA: Yes, if *Buss* & *Blue Ridge* steps followed

NY: No, absent policy language or agreement (*Gjonaj*)

WA: Likely no (absent agrmt.), as inferred from defense-cost cases

FL: Likely same, as inferred from defense-cost cases

Topic 3: Handling Noncovered Portions of Judgments

Allocation of the Judgment

- **Majority Rule**: The **insured bears the burden** of allocating the judgment between covered and noncovered claims. If the insured cannot do this, they may forfeit indemnity coverage for the entire judgment.
- **Special Verdicts**: Courts often encourage or require the use of **special verdict forms** during trial to separate damages. If the insured fails to request this, it can jeopardize their ability to recover under the policy.

Topic 3: Handling Noncovered Portions of Judgments

Post-Verdict Options

- Seek declaratory relief
- Attempt to settle
- Deny indemnity (with caution)

Topic 3: Handling Noncovered Portions of Judgments

Practical Considerations

- ROR strengthens position to contest indemnity
- Notice and communication: Courts may shift the burden of allocation to the insurer if it failed to warn the insured about the need for a special verdict or allocation during trial.
- Be mindful of jurisdictional variance in this area

Topic 3: Handling Noncovered Portions of Judgments

Views of the five states:

TX: Insured bears burden; general verdict jeopardizes coverage; can pierce judgment in coverage litigation

CA: Insurer pays only if verdict clearly supports coverage

NY: Courts emphasize trial record determines coverage

WA: The home of coverage by estoppel (*Truck*).

FL: Judgment precludes re-litigation of decided issues; DJs available to resolve undecided issues

Topic 4: Intervention in Underlying Case

Why an insurer might intervene:

- To **protect its ability to allocate damages** between covered and noncovered claims.
- To **request special verdict forms or interrogatories** that distinguish between covered and noncovered damages.
- To **preserve coverage defenses** and avoid being bound by unfavorable findings under doctrines like **collateral estoppel**.

Topic 4: Intervention in Underlying Case

Risks of not intervening where it's an option:

- In some states, If the insurer does not intervene or request special findings, it may later be **precluded from contesting coverage** for certain damages.
- Courts may interpret silence or inaction as a waiver of certain rights, especially if the insurer defends without a reservation of rights.

Topic 4: Intervention in Underlying Case

Strategic considerations:

- Intervention must be **timely** and follow proper procedural rules.
- It may create **tension with the insured** especially if the insurer's interests diverge from those of the insured.
- Some courts may view intervention as **interfering** with the insured's defense, particularly if the insurer is already providing a defense under a reservation of rights

Topic 4: Intervention in Underlying Case

Views of the five states:

TX: Rare; usually file parallel DJ

CA: Permitted to avoid default against insured (*Reliance*)

NY: Intervention attempt put insureds on notice of necessity to allocate damages, so insurer relieved of indemnity obligation when insureds failed to obtain allocation (*Uvino*)

WA: Labeled as bad faith conduct where it prejudiced insured’s defense (*Paulson*)

FL: Disfavored; “direct and immediate interest” requirement rarely satisfied (*Vaughn*, *James*)

Topic 5: Special Interrogatories

Though the option has long existed, insurers only rarely avail themselves of special jury interrogatories to resolve indemnity coverage issues. Insurers should consider this avenue more frequently. Here’s why:

- Preserving Coverage Defenses
- Burden of Allocation
- Avoiding Estoppel
- Honoring Jurisdictional Variance
- Practical Strategy to Delineate Which Damages are Covered

Topic 5: Special Interrogatories

As a **caveat**, however, defending insurers should be careful not to interfere with defense counsel's discretion in administering the defense, as that may set up a conflict of interest.

Where a conflict (actual or alleged) develops, the appointment of independent (***Cumis***) counsel may ameliorate the problem.

Topic 5: Special Interrogatories

Views of the five states:

TX: Insurer can't direct counsel *(Tilley)*; suggest neutrally

CA: Insurer may request; loss of tool = prejudice (*Earle*)

NY: Requesting helps shift burden; denial not fatal (*Uvino*)

WA: Not addressed, but *Paulson* suggests caution here

FL: Requesting helps shift burden; denial not fatal (*QBE*)

Topic 6: Post-Verdict Coverage Litigation

Allocation of Damages

- **General Rule**: The burden is usually on the **insured** to allocate between covered and uncovered damages. If the insured fails to obtain a special verdict or otherwise distinguish the damages, they may forfeit coverage for the entire judgment.
- **Exception**: Some courts may shift the burden to the **insurer** if it failed to advise the insured about the need for allocation or a special verdict.

Topic 6: Post-Verdict Coverage Litigation

Applicability of Policy Exclusions

- Insurers can litigate whether certain **policy exclusions** apply to bar coverage for some or all the damages. This is especially relevant when the underlying claims include both covered and excluded conduct (e.g., intentional acts vs. negligence).

Topic 6: Post-Verdict Coverage Litigation

Reimbursement of Defense or Settlement Costs

- If the insurer defended under a **reservation of rights**, it may seek **reimbursement** for defense costs or settlement amounts paid for noncovered claims. Courts are split on whether such reimbursement is allowed, and it often depends on:
  - Whether the insurer reserved the right to seek reimbursement.
  - Whether the jurisdiction permits reimbursement absent an express policy provision.

Topic 6: Post-Verdict Coverage Litigation

Collateral Estoppel and Timing

- If the insurer did not timely seek a declaratory judgment or reserve rights, it may be **precluded** from contesting coverage later due to **collateral estoppel** or waiver.

Topic 6: Post-Verdict Coverage Litigation

Views of the five states:

In all the states, an insurer can generally litigate coverage-related issues not adjudicated in tort suit.

Exception: breach of the duty to defend. Where this duty is breached, an insurer will be limited in what it can litigate, to varying degrees depending on the state, with Washington (insurer fully bound by judgment) and Texas (indemnity still open to litigation) representing the polar extremes.

Best Practices for Adjusters

- Always issue a detailed ROR early
- Consider requesting allocation or special verdicts
- Document all coverage communications
- Consult with counsel before settling mixed claims

Thank You / Questions?

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