Piercing Settlements and Judgments in Mixed Covered/Noncovered Claims

Introduction

When an insured faces a lawsuit involving both covered and noncovered claims, unique challenges arise for all parties. The insurer's **duty to defend** typically requires providing a full defense whenever any claim is potentially covered, even if other claims are not.[1] By contrast, the **duty to indemnify** obligates the insurer to pay only for those liabilities actually covered by the policy. This disparity means that 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 properly allocate or "pierce" a global settlement or general jury verdict can lead to disputes and even forfeiture of coverage for the insured or unanticipated payment obligations for the insurer.

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. 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. 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.[2] In some jurisdictions, 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.[3]

This paper first presents a high-level overview and then examines these issues in detail for five jurisdictions – **Texas, California, New York, Washington, and Florida** – based on state supreme court decisions and federal appellate opinions since 2000. For each jurisdiction, we address six key questions:

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1 *National Sur. Corp. v. Immunex Corp.*, 297 P.3d 688, 691 (Wash. 2013) (en banc).

2 *QBE Specialty Ins. Co. v. Scrap Inc.*, 806 Fed. Appx. 692, 695 (11th Cir. 2020) ("Under Florida law, the party claiming insurance coverage has the initial burden to show that a settlement or judgment represents damages that fall within the coverage provisions of the insurance policy. An insured's inability to allocate the amount of a judgment between covered and noncovered damages is therefore generally fatal to its indemnification claim.") (internal citations omitted).

3 *Mutual of Enumclaw Ins. Co. v. Myong Suk Day*, 393 P.3d 786, 792 (Wash. App. 2017) ("If the insurer does not rebut the presumption [of harm from bad faith], the insured is entitled to coverage by estoppel.").

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?

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?

3. **Handling Noncovered Portions of Judgments**: How should an insurer handle a trial verdict/judgment that encompasses liability for both covered and noncovered claims?

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)?

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?

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?

Each jurisdiction's section below is organized by these questions. We cite controlling state supreme court rulings and pertinent federal appellate decisions (2000 to May 2025) to illustrate the prevailing rules.

High-Level Overview

We begin with this high-level overview based on the author's experience of over 37 years as an insurance coverage attorney with a national practice.

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?

In most states, when there is a lawsuit against an insured that includes both covered and noncovered claims, the insurer must take specific steps to preserve its right to later contest coverage or apportionment. Generally, the insurer must:

- **Issue a Reservation of Rights Letter**

  This is a formal notice to the insured that the insurer is providing a defense (or monitoring, if no defense obligation applies), but reserves the right to deny coverage for some or all claims later. It must be timely and specific, clearly identifying the potential coverage issues and the policy provisions that may apply.

- **Provide a Defense (Often Under Reservation)**

  An insurer with a duty to defend typically must defend the entire lawsuit if any claim is potentially covered. This defense is often provided under a reservation of rights, which allows the insurer to later seek reimbursement or apportionment for uncovered claims.

- **Avoid Conflicts of Interest**

  If there is a significant conflict between the insurer's interests and the insured's (e.g., if the outcome of the case could determine coverage), the insurer may need to provide independent counsel (sometimes called *Cumis* counsel in California and other jurisdictions).

- **Seek Declaratory Relief (Optional but Common)**

  In some cases, the insurer may file a declaratory judgment action to have a court determine coverage issues before or during the underlying litigation.

- **Track and Allocate Defense Costs**

  To preserve the right to apportion defense costs later, a defending insurer should track costs associated with covered vs. noncovered claims, if feasible.

In this area, **Illinois is an outlier** in requiring that an insurer must either (1) defend under a reservation of rights, or (2) promptly file a declaratory judgment action to determine coverage. Failure to do either can result in the insurer waiving its right to contest coverage later. This strict approach is rooted in the Illinois Supreme Court's decision in Employers Insurance of *Wausau v. Ehlco Liquidating Trust*, 708 N.E.2d 1122 (Ill. 1999).

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?

Options for dealing with mixed settlements are jurisdiction-specific, but generally include the following:

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.

3. Handling Noncovered Portions of Judgments: How should an insurer handle a trial verdict/judgment that encompasses liability for both covered and noncovered claims?

In most states, when a trial verdict or judgment against an insured includes both covered and noncovered claims, and the litigation has concluded, insurers face a complex set of procedural and practical options. Here's a general summary of how insurers typically handle this situation:

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.

Insurer's Post-Verdict Options

Once the trial is over and no further defense is required, the insurer generally has the following options:

Seek Declaratory Relief

- The insurer may file a **declaratory judgment action** to have a court determine the extent of its indemnity obligations.

- This is especially common when the verdict is a **general verdict** (i.e., it doesn't distinguish between covered and uncovered damages).

Attempt to Settle or Negotiate

- The insurer may try to **negotiate a settlement** with the insured or the judgment creditor, allocating a reasonable portion of the judgment to covered claims.

- This can avoid further litigation and potential bad faith exposure.

Deny Indemnity (with Caution)

- If the insured failed to obtain a special verdict or otherwise cannot allocate damages, the insurer may **deny coverage** for the entire judgment.

- However, this carries **bad faith risk** if the insurer did not adequately advise the insured during litigation about the need for allocation.

Practical Considerations

- **Reservation of Rights**: If the insurer defended under a reservation of rights, it strengthens their position to later 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.

- **Jurisdictional Variance**: Some states may impose different burdens or allow for post-verdict allocation proceedings.

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)?

In most states, a liability insurer may intervene in an underlying liability lawsuit involving mixed covered and noncovered claims, but whether it *should* intervene depends on several legal and strategic considerations.

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**.

Risks of Not Intervening:

- 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.

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.

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?

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

If a general verdict is returned without distinguishing between covered and noncovered damages, courts may interpret the ambiguity **against the insurer**, potentially obligating it to pay for damages that are not covered under the policy.

Burden of Allocation

Some courts have held that once an insured proves a judgment and a policy that potentially covers it, the **burden shifts to the insurer** to prove what portion of the judgment is not covered. Without a special verdict form or interrogatories, this can be nearly impossible.

Avoiding Estoppel

If the insurer fails to intervene or request special findings, it may be **estopped** from later contesting coverage. Some courts have ruled that insurers who do not act to protect their interests during the underlying trial may lose the right to litigate coverage issues afterward.

Jurisdictional Variance

While the general principle is widely accepted, the **specific rules and procedures vary by state**. Some states have formal mechanisms for insurer intervention (e.g., Rule 24 of the Federal Rules of Civil Procedure or state equivalents), which can allow the insurer to request special verdicts or interrogatories.

Practical Strategy

Requesting special interrogatories or a special verdict form helps ensure that the **jury's findings clearly delineate** which damages are attributable to covered versus noncovered claims, aiding in post-trial allocation and reducing litigation over coverage.

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 counsel may ameliorate the problem.

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?

In most states, after an insured settles or is subject to a judgment involving both covered and noncovered claims, a liability insurer can litigate several key issues in a declaratory judgment action. These typically include:

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.

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).

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.

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.

Texas

1. Preserving Apportionment or Coverage Issues

Though the Texas Supreme Court has long enabled and encouraged liability insurers to file declaratory judgment actions to resolve coverage issues early – even on the duty to indemnify, under certain circumstances[4] – Texas law also protects the insurer's right to litigate coverage issues even if the insurer breaches the duty to defend.[5]

One recent Texas Supreme Court decision highlights the state's approach to post-judgment coverage fights. In *In re Illinois Nat'l Ins. Co.* (Tex. 2024), the insured (Cobalt) faced a securities suit, the insurer denied defense, and the insured then settled with the claimant in a **no-recourse judgment** (the claimant agreed to seek recovery only from the insurance).[6] The Texas Supreme Court held the settlement made the insured "legally obligated" (triggering a loss under the policy and allowing a direct action by the claimant), **but** it also held the insurer was *not bound* by the settlement's terms in the ensuing coverage litigation.[7] In other words, the insurer could contest coverage and was free to litigate whether the claims were covered, despite the insured and claimant's agreement on an amount.[8]

This underscores that in Texas, even after a judgment or settlement, an insurer may litigate coverage questions (exclusions, allocation, etc.), and it will not be precluded by the mere fact

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[4] *Farmers Texas County Mutual Ins. Co. v. Griffin*, 955 S.W.2d 81, 84 (Tex. 1997) ("We now hold that the duty to indemnify is justiciable before the insured's liability is determined in the liability lawsuit when the insurer has no duty to defend ***and the same reasons that negate the duty to defend likewise negate any possibility the insurer will ever have a duty to indemnify***.") (emphasis in original).

[5] *Western All. Ins. Co. v. N. Ins. Co. of New York*, 176 F.3d 825, 830 (5th Cir. 1999) ("Assuming Northern breached its duty to defend, it may still challenge indemnification.... It remains free ... to argue that the assumed liability was not in actuality covered under its policy, and thus no duty to indemnify arises.") (citing *Employers Casualty Company v. Block,* 744 S.W.2d 940, 943 (Tex.1988), *overruled on other grounds by State Farm Fire and Casualty Co. v. Gandy,* 925 S.W.2d 696, 714 (Tex.1996)).

[6] *In re Illinois Nat'l Ins. Co.*, 685 S.W.3d 826, 833 (Tex. 2024).

[7] *Id.* at 840-42.

[8] The *Illinois National* ruling was a re-affirmance of *Great Am. Ins. Co. v. Hamel*, 525 S.W.3d 655, 664-66 (Tex. 2017) (pretrial agreement between homeowners and insured rendered underlying trial not fully adversarial, and thus resulting judgment was not enforceable against insurer or admissible as evidence in trial against insurer).

that a judgment has been entered. The insurer can raise any policy defenses to paying the judgment, and the *Illinois National* case confirms that a settlement agreement between insured and claimant does not bind the insurers on coverage. Of course, if the insurer **wrongfully refused to defend** a covered claim, it can be liable for breaching that duty (and perhaps for related damages or attorney's fees), but Texas will not transform a noncovered liability into a covered one by estoppel.

Still, insurers should follow best practices to minimize coverage disputes. An insurer should **timely reserve its rights** and actively protect its interests during the underlying litigation to later argue about coverage allocation. It should err on the side of defending the insured. It should send a robust reservation-of-rights letter detailing which claims may not be covered and its intent to later contest indemnity for those claims.[9] If a settlement or verdict could potentially lump together covered and noncovered damages, the insurer should **notify the insured** of the need to allocate those damages and even seek agreement on an allocation procedure beforehand.

Though often not possible, it is worthwhile to seek a **nonwaiver agreement** from the insured. For example, in *American Int'l Specialty Lines Ins. Co. v. Res-Care, Inc.*, the Fifth Circuit applying Texas law approved the insurer's use of a nonwaiver agreement to preserve apportionment issues. The insurer defended under reservation and, before funding a global settlement, executed an agreement with the insured expressly stating that the insurer could later recoup any amounts paid for noncovered claims.[10] The Fifth Circuit noted this agreement "satisfied the conditions of *Matagorda County*" – referring to the Texas Supreme Court's ruling in *Matagorda County* (2000) that an insurer cannot seek reimbursement from its insured for a settlement payment absent the insured's express agreement or a contractual provision.[11] By obtaining the insured's consent and reserving the issue, the insurer in *Res-Care* preserved its right to allocate the settlement between covered and noncovered claims in a later proceeding.

To minimize the need for coverage litigation, an insurer should also consider pointing out to the insured that the insured bears the burden of proof on apportioning between covered and noncovered damages, and suggesting the use of **special jury questions or findings** distinguishing the bases for liability or types of damages, while taking care not to interfere in

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[9] *Texas Ass'n of Ctys. Cnty. Gov't Risk Mgmt. Pool v. Matagorda Cnty.*, 52 S.W.3d 128, 133 (Tex. 2000) ("'An insurer's reservation of rights is the notification to the insured that the insurer will defend the insured, but that the insurer is not waiving any defenses it may have under the policy, and it protects an insurer from a subsequent attack on its coverage position on waiver or estoppel grounds.'") (quoting with approval *Medical Malpractice Joint Underwriting Ass'n v. Goldberg*, 680 N.E.2d 1121, 1129 n. 31 (Mass. 1997)).

[10] *American Int'l Specialty Lines Ins. Co. v. Res-Care Inc.*, 529 F.3d 649, 656 (5th Cir. 2008).

[11] *Id.* (citing *Texas Ass'n of Counties County Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 135 (Tex. 2000)).

defense counsel's discretion on trial tactics. While no Texas Supreme Court case explicitly mandates requesting a special verdict, Texas courts recognize that failing to segregate covered from noncovered damages can be fatal to a coverage claim.[12] Thus, the insured, preferably through its independent coverage counsel (to avoid defense counsel conflicts), should be encouraged to seek special jury questions or findings. Otherwise, a general verdict that obscures coverage may result. In such a case, Texas follows the majority rule placing the burden on the insured (or claimant seeking coverage) to provide evidence allocating the verdict between covered and noncovered losses.[13]

In sum, Texas law is favorable to insurers on preservation, but insurers should follow best practices and (a) reserve rights early and specifically, (b) obtain the insured's consent to any post-verdict allocation or reimbursement rights if possible, and (c) urge an allocated verdict or settlement on the record. These steps prevent waiver of coverage defenses and ensure the insurer can later litigate what portion of the outcome is covered.

2. Handling the Noncovered Portion of a Settlement

Texas law is protective of insureds in the settlement context: an insurer cannot simply pay a settlement that includes noncovered claims and later demand reimbursement from the insured unless the insured agreed to that arrangement. In *Texas Ass'n of Counties Govt. Risk Mgmt. Pool v. Matagorda County*, the Texas Supreme Court held that an insurer had no unilateral right to recoup settlement payments for a noncovered claim absent the insured's express agreement to reimburse.[14] The court stressed that, without a contract term or the insured's consent, requiring the insured to repay amounts would unjustly modify the policy.[15] This rule was reaffirmed in the *Excess Underwriters at Lloyd's v. Frank's Casing* saga. In 2005, the Texas Supreme Court initially allowed an insurer's reimbursement claim when it had reserved that right,[16] but on rehearing in 2008 the court reversed course, ultimately holding that no reimbursement is allowed unless the insured agreed (thus aligning with *Matagorda County*).[17]

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[12] *Great Am. Ins. Co. v. Emps. Mut. Cas. Co.*, 18 F.4th 486, 492 (5th Cir. 2021) ("The coverage-seeking party carries the allocation burden, and a failure to allocate covered and non-covered damages is fatal to recovery.") (citing *Travelers Indem. Co. v. McKillip*, 469 S.W.2d 160, 163 (Tex. 1971)).

[13] *Great Am.*, 18 F.4th at 492.

[14] *Texas Ass'n of Ctys. Cnty. Gov't Risk Mgmt. Pool v. Matagorda Cnty.*, 52 S.W.3d 128, 131 (Tex. 2000).

[15] *Id.*

[16] No. 02-0730, 48 Tex. Sup. Ct. J. 735, 2005 WL 1252321 (Tex., May 27, 2005) (withdrawn).

[17] 246 S.W.3d 42, 49-50 (Tex. 2008).

Practical effect: If a global settlement demand includes both covered and noncovered matters, an insurer has two main options. **Option 1** is to **refuse to pay the noncovered portion**, offering to fund only the covered claims. (The insurer should communicate clearly which claims it considers noncovered.) However, this runs the risk that the settlement could fall through, potentially exposing the insured to a larger judgment – which raises *Stowers* duty (duty to settle within limits) concerns if the covered exposure alone is within policy limits.

Option 2 is to **contribute to the entire settlement under a non-waiver agreement**, then pursue allocation in a later coverage action. The *Res-Care* case illustrates this approach: the insurer paid a $9 million settlement that resolved both compensatory (covered) and punitive (noncovered) claims, but only after the insured signed an agreement preserving the insurer's right to recoup the punitive-damage portion.[18] The insurer then filed a post-settlement coverage action, and the court held a separate **allocation trial** to determine what share of the settlement was for punitive damages (noncovered) versus compensatory damages (covered). The court found $5 million of the settlement was punitive and entered judgment requiring the insured to reimburse that amount.[19] Because the insurer had explicitly reserved and contractually secured its recoupment rights, this outcome was upheld on appeal. By contrast, without such an agreement, the insurer would have had no recourse to recover the noncovered portion, effectively gifting that amount to the insured or claimant.

In summary, in Texas an insurer should **never simply pay for noncovered claims** in a settlement without protection. Ideally, the insurer will get the insured's consent to allocate or reimburse beforehand. If the insured refuses, the insurer must carefully weigh the risk of not settling versus the inability to recover the payment. Thus, handling noncovered settlement exposure in Texas often requires creative lawyering – e.g., splitting settlement contributions between insurer and insured, obtaining a non-waiver agreement, or filing a concurrent declaratory judgment action to clarify coverage before settlement funds are paid.

3. Handling the Noncovered Portion of a Judgment

When a case goes to verdict in Texas, the insurer's obligation to indemnify extends only to covered damages or causes of action. If the judgment *explicitly* delineates which damages or findings are tied to covered claims versus noncovered claims, the insurer can simply pay the covered portion and deny the rest. The more difficult scenario is a **general verdict** (or undifferentiated damages award) where some theories of liability were covered and others were not. Texas courts generally place the **burden on the insured to prove that a judgment (or some portion of it) is attributable to a covered claim**.[20] If the insured cannot meet this burden – for

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[18] *Res-Care*, 529 F.3d at 655.

[19] *Id.* at 655-56.

[20] *Great Am.*, 18 F.4th at 492.

example, if the jury's verdict does not specify the grounds or types of damages – then the insured may be unable to establish the insurer's indemnity liability, resulting in no coverage for the judgment *at all*.[21]

To avoid this harsh result, insurers and defense counsel in Texas should strive to have the jury **answer special interrogatories** or use a verdict form that allocates damages by claim or category, provided the insurer does no interfere in defense counsel's trial strategy (a topic addressed below). If an insurer defends under a reservation of rights, it has a clear interest in such allocation, as it will avoid the necessity of a separate allocation trial. The insured also has an interest because, if a verdict is ambiguous, the insurer in a DJ action can argue that the insured cannot carry its burden to parse the verdict, and a court may then either take evidence to allocate the judgment or declare that the insured failed to prove any covered damages.

Notably, Texas does **not** follow the rule of some estoppel-oriented states that an insurer who breaches the duty to defend or refuses to apportion is automatically on the hook for the entire judgment. Even a breach of the duty to defend does not create coverage for claims that the policy did not cover (as the Texas Supreme Court reaffirmed in *Great Amer. Ins. Co. v. Hamel*,[22] and as New York's courts likewise hold, see New York section). Texas allows an insurer to litigate coverage after a judgment, with the insured or judgment-creditor bearing the burden to establish that the judgment (or a portion of it) represents liability for covered claims. If the insurer was not involved in the trial (due, e.g., to a coverage denial), Texas courts will examine the **duty to indemnify based on the actually litigated facts** and policy terms, not merely the theories alleged.[23]

For example, if the jury in the underlying case could have found the insured liable on a noncovered theory, and the verdict does not clarify the basis, Texas courts may hold that the insured failed to prove the loss was covered. On the other hand, if the only theory of liability actually submitted to the jury was covered, the entire judgment would be covered. The key point is that Texas will *pierce the judgment* to align it with coverage, rather than simply binding the insurer to pay the full amount regardless of coverage. The *Illinois National* case, addressed in Section 1 above, is a relatively recent example in this area.

4. Insurer Intervention in the Underlying Case

Texas courts have not mandated intervention. Ordinarily, Texas insurers do not intervene in their insured's tort litigation, as Texas adheres to the **"no direct action" rule** (a claimant

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21 *Id.*

22 525 S.W.3d 655 (Tex. 2017).

23 *D.R. Horton-Texas, Ltd. v. Markel Int'l Ins. Co.*, 300 S.W.3d 740, 744 (Tex. 2009) ("[I]t is well settled that the 'facts actually established in the underlying suit control the duty to indemnify.' As with any other contract, breach or compliance with the terms of an insurance policy is determined not by pleadings, but by proof.") (internal citations omitted).

generally cannot sue the insurer in the injury case) and intervention could pose conflicts of interest. A risk of intervention is that the insurer could be seen by the jury as a "deep pocket," prejudicing the defense. While Texas Rule of Civil Procedure 60 allows a party with a justiciable interest to intervene, courts could find an insurer's interest in coverage is too collateral to the liability issues. In practice, Texas insurers more often file a **separate declaratory judgment action** to address coverage (sometimes running parallel to the liability case) rather than intervening in the tort suit.

In a rare published exception to the general trend, in *In re Lumbermens Mutual Casualty Co.*,[24] the Texas Supreme Court addressed whether an insurer could intervene in its insured's appeal to raise a choice-of-law issue that the insured had abandoned. The court held that, under the unique circumstances of the case, the court of appeals abused its discretion by denying Lumbermens' intervention. The court reasoned that Lumbermens had a significant financial interest in the outcome of the appeal due to the $29 million bond it posted and that its interests were not adequately represented once the insured abandoned the choice-of-law issue. The court emphasized that the virtual representation doctrine allows a non-party to appeal a judgment if it is bound by the judgment, its privity of interest appears from the record, and there is an identity of interest between the non-party and a named party to the judgment. Given that Lumbermens' and the insured's interests diverged, Lumbermens could no longer rely on virtual representation and was entitled to intervene to protect its interests.

The *Lumbermens* decision clarifies that an insurer may intervene in an appeal to protect its interests when the insured abandons a potentially dispositive issue, especially when the insurer has a substantial financial stake in the outcome. It underscores the importance of timely intervention when an insurer's and insured's interests diverge during litigation. There are few other examples of insurer intervention in Texas, however, so it is the exception that proves the rule.

5. Special Jury Interrogatories

In Texas, the use of special interrogatories or a special verdict form in cases involving both covered and noncovered claims can be a mechanism to clarify the basis for liability and the allocation of damages. However, any analysis of this option must account for Texas Supreme Court precedents, particularly *State Farm v. Traver*,[25] *Northern County Mutual v. Davalos*,[26] and *Employers Casualty Co. v. Tilley*,[27] which restrict an insurer's ability to direct or control defense counsel once appointed.

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[24] 184 S.W.3d 718 (Tex. 2006).

[25] 980 S.W.2d 625 (Tex. 1998).

[26] 140 S.W.3d 685 (Tex. 2004).

[27] 496 S.W.2d 552 (Tex. 1973).

Under Texas law, when an insurer provides a defense under a reservation of rights, defense counsel still owes its full and unqualified duty of loyalty to the insured—not the insurer. In *Traver*, the Texas Supreme Court emphasized that while the insurer may have the right to select defense counsel, it **does not have the right to control the details of the attorney's defense strategy**, reaffirming that defense counsel's primary duty is to the insured, not the insurer.[28] The Texas Supreme Court in *Davalos* wrote an insured may rightfully refuse to accept an insurer's defense when "the attorney hired by the carrier acts unethically and, at the insurer's direction, advances the insurer's interests at the expense of the insured's," or when "the insurer attempts to obtain some type of concession from the insured before it will defend."[29] Similarly, *Tilley* prohibits insurer interference that could create a conflict of interest or undermine the insured's position in the litigation.[30]

As such, insurers in Texas should **not instruct or direct** defense counsel to submit special jury questions or interrogatories, even where the distinction between covered and noncovered claims is critical. Doing so could violate *Traver*, *Davalos* and *Tilley*, particularly if the insurer is attempting to shape the litigation to preserve future coverage arguments.

Instead, the insurer should:

- **timely communicate its position in writing** to the insured, explaining that the outcome of the trial may determine the scope of coverage and that a general verdict may create allocation problems;

- **refrain from giving directives** about the content of jury charges, but note to the insured that the absence of special findings could complicate any indemnity analysis;

- **document its reservation of rights** and its concern that a general verdict might not distinguish between covered and noncovered claims; and

- **offer the insured the option of independent counsel** under *Tilley* if a conflict arises over how to proceed with the jury charge or other key strategy decisions.

Texas courts have not held that failure to obtain special jury findings automatically defeats coverage, but they have made clear that the burden to establish coverage remains on the insured. Where the verdict form does not allow for segregation, and the evidence does not permit a court to allocate covered and noncovered damages, the insured may be unable to prove its entitlement to indemnity, as discussed above.

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28 980 S.W.2d at 627.

29 140 S.W.3d at 689.

30 496 S.W.2d at 558-60.

In practice, if defense counsel acting in the insured's sole interest determines that special interrogatories serve the insured's goals (e.g., to preserve coverage, avoid appealable error, or ensure clarity in the judgment), counsel may independently choose to request such interrogatories. Texas Pattern Jury Charges support this approach, and courts have discretion to submit granulated questions when appropriate.

In summary:

- Insurers must not direct defense counsel to seek special interrogatories.
- They may communicate their position about the benefits of segregation—but only to the insured and in neutral, non-directive terms.
- Whether to request special verdicts remains solely within defense counsel's judgment, exercised in the insured's best interest.

This approach complies with Texas precedent, minimizes the risk of conflict, and helps preserve the insurer's defenses without breaching its duty under *Traver*, *Tilley* or *Davalos*.

6. Post-Settlement or Post-Judgment Declaratory Judgment Actions

Texas law encourages resolution of coverage disputes through **declaratory judgment actions**, either parallel to the liability case or afterward. After a settlement or judgment that only partially implicates coverage, an insurer in Texas can litigate numerous issues in a DJ action without being deemed to have waived them. Key points the insurer can address include:

(a) which portions of the settlement or judgment correspond to covered claims;
(b) the applicability of any policy exclusions to the facts that were established in the underlying case;
(c) whether the insurer has any reimbursement rights for amounts paid (in light of any reservation or agreement); and
(d) if the settlement was negotiated without the insurer's consent (in a coverage dispute context), whether the settlement was reasonable and made in good faith.

Even where an insurer has breached the duty to defend, as the recent *Illinois National* case shows, the insurer can contest coverage and is not bound by stipulations between insured and claimant. The Texas Supreme Court noted that because the insured in that case faced no personal liability beyond insurance, the insurer had not had its day in court on coverage and thus could litigate those issues in the DJ action.[31]

The Texas Supreme Court has recognized that the facts necessary to establish coverage "are not required to be proven in an underlying trial against the insured and are often proven in

[31] *Illinois Nat'l*, 685 S.W.3d at 840-42.

coverage litigation."[32] Thus, there may be occasions, such as when the parties settle the plaintiff's liability claim without a trial, in which it will be necessary for the parties to submit new or additional evidence in the coverage litigation—either in a coverage trial or in a summary judgment proceeding—to determine the question of the insurer's duty to indemnify.[33] As the Fifth Circuit has recognized, "[t]he underlying case often does not resolve all the factual issues necessary to determine coverage because issues relevant to the question of coverage can be irrelevant to the question of the insured's liability."[34]

Thus, in a DJ action following a mixed-claim outcome, the insurer can rely on the **actual trial record or settlement documents** to inform the coverage analysis. Importantly, Texas follows the rule that the duty to indemnify is determined by the facts established (by judgment, jury findings, or evidence) and not strictly by the eight-corners rule that governs the duty to defend. This means the insurer can introduce extrinsic evidence from the underlying case to show, for example, that a portion of damages was for an excluded cause of loss. In *Res-Care*, the insurer did exactly that in an allocation trial post-settlement: it brought in evidence to show the intent of the $9 million settlement and how much was likely punitive damages. The Fifth Circuit approved considering such evidence, noting that in an allocation proceeding the goal is to determine *"what portion of the settlement was reasonably intended to be allocated to covered amounts."*[35]

Furthermore, an insurer can use a DJ action to assert that it has **no duty to indemnify** a particular judgment at all if, for instance, the only theory of liability actually upheld by the court was excluded by the policy. A classic example is a jury finding of intentional misconduct (which is not covered) even though negligence was alleged. If the jury implicitly found intentional conduct, the insurer can seek a declaration of no coverage. The DJ action can also address **coverage defenses such as late notice, breach of policy conditions, or lack of cooperation**, to the extent relevant, even after the underlying case concludes.

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[32] *See In re Farmers Tex. Cnty. Mut. Ins. Co.*, 621 S.W.3d 261, 276 (Tex. 2021) (citing *D.R. Horton-Texas, Ltd. v. Markel Int'l Ins. Co.*, 300 S.W.3d 740, 744 (Tex. 2009)).

[33] *In re Farmers*, 621 S.W.3d at 276; *see also D.R. Horton*, 300 S.W.3d at 744 (citing *National Union Fire Ins. Co. v. Puget Plastics Corp.*, 532 F.3d 398, 404 (5th Cir. 2008) (recognizing that a party may present evidence at a coverage trial on the issue of an insured's duty to indemnify, where the "facts necessary to determine coverage … were not adjudicated in the underlying case")); *United Fire Lloyds v. JD Kunz Concrete Contractor, Inc.*, No. 08-23-00047-CV, 2023 WL 7171475, at *16 (Tex. App. Oct. 31, 2023, pet. denied).

[34] *Puget Plastics Corp.*, 532 F.3d at 404; *see also Swicegood v. Med. Protective Co.*, No. CIV.A.3:95-CV-0335-D, 2003 WL 22234928, at *14 (N.D. Tex. Sept. 19, 2003) (construing Texas law to allow "new evidence" at a "coverage trial when the proof is necessary to resolve a controlling coverage question that was not conclusively decided in the indemnity suit," such as when an insurer raises an exclusion issue to avoid coverage); *JD Kunz*, 2023 WL 7171475, at *16.

[35] *Res-Care, Inc.*, 529 F.3d at 656.

Texas does *not* hold that a breach of the duty to defend estops an insurer from asserting exclusions (unlike the law in Washington for bad-faith breaches). In fact, the New York Court of Appeals' *Servidone*[36] rule (breach of defense does not create coverage) is mirrored in Texas jurisprudence.[37] Thus, in a Texas DJ case, an insurer who wrongfully refused to defend might have to indemnify the insured for a *covered* judgment or settlement (and could owe extra-contractual damages for the breach), but the insurer can still contend that the loss was outside coverage entirely. If proven, the insurer would win on coverage despite its breach (though it might still owe defense costs and perhaps interest).

In summary, a Texas insurer in a declaratory judgment action after a partially covered outcome can litigate (1) the allocation of damages between covered and noncovered claims; (2) the applicability of policy exclusions or limits to the established facts; (3) the enforceability of any insured–claimant settlement against the insurer; and (4) any right to reimbursement of amounts the insurer paid but was not obligated to pay (keeping in mind *Matagorda County* – no recoupment absent consent[38]). The DJ court effectively "pierces" the prior result to assign financial responsibility in accordance with the policy. Texas courts aim to ensure the insurer pays for what it agreed to cover, and nothing more, unless the insurer's own wrongdoing (e.g. *Stowers* neglect or bad faith) justifies a broader penalty.

To conclude the Texas section: Texas strikes a balance between honoring the insurance contract and protecting insureds from unfair surprise. Insurers who diligently reserve rights, communicate the need for allocation, and pursue declaratory relief can avoid paying noncovered losses. Insureds, for their part, must assist in separating claims or risk losing coverage for an undifferentiated award. The jurisprudence since 2000 confirms that Texas will not automatically saddle insurers with noncovered liabilities, but it expects insurers to **proactively safeguard their rights** throughout the process.

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36 *Servidone Constr. Corp. v. Sec. Ins. Co. of Hartford*, 477 N.E.2d 441, 444-45 (N.Y. 1985).

37 *Western All. Ins. Co. v. N. Ins. Co. of New York*, 176 F.3d 825, 830 (5th Cir. 1999) ("Assuming Northern breached its duty to defend, it may still challenge indemnification.... It remains free ... to argue that the assumed liability was not in actuality covered under its policy, and thus no duty to indemnify arises.") (citing *Employers Casualty Company v. Block,* 744 S.W.2d 940, 943 (Tex.1988), *overruled on other grounds by State Farm Fire and Casualty Co. v. Gandy,* 925 S.W.2d 696, 714 (Tex.1996)).

38 *Matagorda*, 52 S.W.3d at 135.

California

1. Preserving Apportionment or Coverage Issues

California law gives an insurer the tools to protect its right to argue apportionment—but they must be used carefully and deliberately. California continues to follow precedent from California Supreme Court case *Buss v. Superior Court* (Cal. 1997), which not only allows insurers to defend an action without waiving its right to assert the noncoverage defense later, but also allows the insurer to seek reimbursement for defense costs related to claims not potentially covered.[39] However, this right is contingent upon a timely reservation of rights[40] and taking specific procedural steps during the underlying litigation.

In *Blue Ridge Ins. Co. v. Jacobsen*, the California Supreme Court reaffirmed *Buss's* holding that an insurer may seek reimbursement for settling claims ultimately determined to be noncovered, even when the insureds withhold consent to the settlement.[41] The court described that an insurer can seek such reimbursement by: (1) making a timely and express reservation of rights; (2) providing an express notice to the insureds of its intent to accept a proposed settlement offer and; (3) providing an express offer to the insureds that they may assume their own defense should they disagree with its decision to accept or reject a proposed settlement.[42]

In this case, Blue Ridge disputed coverage under the insured's homeowner's policy for injuries sustained in a dog attack, but defended the suit nonetheless under a reservation of rights. When a reasonable settlement was offered, the insureds objected to the insurer accepting the settlement on the condition of reimbursement for noncovered claims. The insureds also refused to assume their own defense. The Court asked whether the insureds must agree to the settlement in order for the insurer to be reimbursed. The Court held that in this instance, the insureds were on notice by both the policy language and the express reservation of rights letter that the insurer might seek reimbursement for claims determined to be noncovered. Additionally, the insurer offered the insureds the opportunity to assume their own defense should they disagree with the proposed settlement. The prerequisites for seeking reimbursement were met and the insurer was able to recoup costs for noncovered claims.

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[39] *See Buss v. Superior Court*, 16 Cal.4th 35 (Cal. 1997).

[40] "Through reservation, the insurer avoids waiver." *Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal.4th 489, 501 (Cal. 2001) (quoting *Buss v. Superior Court*, 16 Cal.4th at 61, fn. 27). "If the insurer adequately reserves its right to assert the noncoverage defense later, it will not be bound by the judgment." *Id.* at 490.

[41] *Id.* at 489.

[42] *Id.* at 489–90.

Blue Ridge emphasizes the importance of an insurer reserving its rights and clarifies that an insurer can unilaterally reserve its right to assert noncoverage "merely by giving notice to the insured."[43] **An insured is deemed to have accepted the reservation of rights by accepting the insurer's defense under these circumstances.** *Blue Ridge* illustrates California's acceptance of quasi-contractual rights—specifically, that an insurer should not be forced to bear the cost of settling claims it never agreed to cover, so long as the insured is on notice. The right to reimbursement may be implied in the terms of the policy because the insurer has only agreed to indemnify certain contemplated claims. Through a reservation of rights, the insurer is giving the insured the opportunity to accept the defense under the insurer's control or to proceed to defend itself as it sees fit.

An insurer wishing to protect its right to contest coverage should be particular in the language they use both in its written policy and its reservation of rights letters. A robust reservation of rights letter should spell out exactly what the insurer plans to cover, what it is disputing, and that it may seek reimbursement for noncovered claims. Additionally, rights should be reserved early in the litigation, putting the insured on notice from the start. Should the matter proceed to settlement, an insurer can further protect its right to reimbursement by being transparent about the intent to settle and giving the insured the opportunity to assume their own defense. Before accepting any settlement offer, the insurer should communicate with the policyholder and reiterate its intention to reserve its rights. If the policyholder refuses settlement, the insurer should make it clear to the policyholder that they have the opportunity to take over their own defense. If they refuse, the insurer is protected and may proceed with the settlement without forfeiting its right to reimbursement. California prioritizes communication between the insured and insurers, and insurers should take proactive, transparent steps to inform insureds of its rights, coverage positions, and settlement intentions—especially when reserving rights or seeking reimbursement for noncovered claims.

Another key aspect of preserving the right to contest coverage for defending insurers is the appointment of independent or "*Cumis*" counsel where a conflict of interest arises due to a reservation of rights.[44] Whether failure to do so can result in estoppel to contest coverage is at least an open question that insurers should avoid testing.[45]

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[43] *Id*. at 498.

[44] *See San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc*., 162 Cal. App. 3d 358, 361, 375 (1984) (established the right to independent counsel when a conflict exists; now superseded by statute); CAL. CIV. CODE § 2860 (requires independent counsel when the insurer's reservation of rights creates a conflict).

[45] *See Dynamic Concepts, Inc. v. Truck Ins. Exch*., 61 Cal. App. 4th 999, 1007-08 n.6 (1998) ("We do not decide whether an insurer may be estopped from seeking reimbursement from its insured for the defense costs of uncovered claims when it insists upon appointed counsel rather than allowing the insured to control the defense, with its accompanying control and oversight over defense fees and costs.") (citing *Tomerlin v. Canadian Indemnity Co*. (1964) 61 Cal. 2d 638, 39 Cal. Rptr. 731, 394 P.2d 571 (carrier estopped from relying on coverage defense after inducing insured to withdraw personal counsel)).

2. Handling Noncovered Portions of Settlements

Because insurers have a contractual duty to defend a mixed action in its entirety, the insurer may find itself settling an action involving both covered and noncovered claims. **When an insurer has properly reserved its right to contest coverage and recoup amounts paid in settlement, they can expect to recover costs for the noncovered portions of the settlement.** This rests on the premise that an insurer only has a duty to indemnify claims for which the insured has paid premiums.[46] The recovery may be sought from the insured. Otherwise, the insured receives an unjust enrichment in the form of the eliminated potential liability.

The right to recover settlement payments for noncovered claims is distinct from the right to recover defense costs. Under California law, an insurer may seek reimbursement for settlement payments made on claims that are not actually covered by the policy, provided it has properly reserved its rights. This principle is rooted in the understanding that the insurer has not contracted to indemnify the insured for claims falling outside the scope of coverage, and thus, the insured should not retain the benefit of such payments without providing consideration.

This distinction is illustrated in *AXIS Surplus Co. v. Reinoso*, where the insurer (AXIS) defended under a reservation of rights, contributed to a settlement, and later sought reimbursement for both settlement and defense costs.[47] The court permitted AXIS to recover the portion of the settlement attributable to claims that were not covered by the policy, but denied reimbursement of defense costs because AXIS failed to show that the defense was "solely allocable to claims that were not even potentially covered." [48] This principle, established in *Buss v. Superior Court*, affirms that an insurer may not seek reimbursement for defense costs associated with claims that are at least "potentially covered," because the duty to defend under a liability policy extends to such claims.[49] *AXIS Surplus* thus affirms the separation between these two forms of recovery: **a showing that the claims were not even potentially covered is necessary for recovery of defense costs, but not for recovery of settlement costs.**

This case affirms that insurers may recover settlement payments made on noncovered claims, even where a defense was provided, as long as the claims fall outside the scope of actual coverage. This protects insurers from unjust enrichment of the insured and ensures that the contractual allocation of risk is respected. While the burden remains on the insurer

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[46] *Id.* at 502–03.

[47] *AXIS Surplus Ins. Co. v. Reinoso*, 208 Cal.App.4th 181, 185 (2012).

[48] *Id.* at 193 (quoting *Buss v. Superior Court*, 16 Cal.4th 35, 53, 57 (Cal. 1997)).

[49] *Buss*, 16 Cal.4th at 49.

to prove non-coverage, the right to reimbursement of settlement payments does not hinge on the more demanding "no potential coverage" standard applicable to defense costs.

3. Handling Noncovered Portions of Judgments

Where a trial verdict or judgment encompasses liability for both covered and noncovered claims, the insurer is only obligated to indemnify the portion of liability attributable to the covered claims. In California Appeal case *Collin v. American Empire Insurance Company*, plaintiffs sued an insurer to collect a default judgment against its insured for conversion and damage to real property.[50] The trial court initially found that the damage was covered under the insurance policy, but the insurer appealed, arguing that the judgment was based on intentional misconduct rather than an 'accident' as required for coverage. The Court of Appeal agreed, concluding that the conversion was not accidental because the cross-complaint alleged deliberate conduct, and it reversed the portion of the judgment against the insurer. The court held that "while an insurer has a duty to defend suits which potentially seek covered damages, it has a duty to indemnify only where a judgment has been entered on a theory which is actually (not potentially) covered by the policy."[51]

When a verdict includes both covered and noncovered claims, the insurer must carefully analyze the basis of the judgment to determine whether any part of the liability is actually covered under the policy—not just potentially. The duty to indemnify arises only if the judgment is based on a theory that falls squarely within the policy's coverage. *Collin* also makes clear that when the facts aren't in dispute, interpreting an insurance policy is a legal question, and the appeals court does not have to follow the trial court's interpretation of that policy. Insurers should feel empowered to question a trial court's interpretation of the policy if the facts are undisputed and the issue turns solely on how the policy language applies. If the judgment is ambiguous or does not clearly separate covered from noncovered claims, the insurer should assert all relevant defenses, seek judicial clarification or allocation, and preserve its right to contest indemnity by issuing a clear reservation of rights throughout the litigation. This approach ensures the insurer fulfills its obligations without paying for noncovered liabilities.

4. Intervention in the Underlying Case

California law permits an insurer to intervene when it has a direct interest in the matter that may be impaired or impeded by the disposition of an action. Under California Code of Civil Procedure section 387, a non-party may intervene in an action if they claim "an interest relating to the property or transaction that is the subject of the action and [are] so situated that the disposition of the action may impair or impede [their] ability to protect that interest."[52] An insurer should be prepared to intervene whenever it remains liable for any default judgment against the insured

[50] *Collin v. Am. Empire Ins. Co.*, 21 Cal.App.4th 787, 795 (1994).

[51] *Id.* at 803.

[52] CAL. R. CIV. P. § 387.

and has no other means to litigate liability.[53] In order to intervene, the insurer must demonstrate that its interest in the litigation is direct rather than consequential. For example, whenever an insurer admits coverage, it has a direct and immediate interest in the action and may intervene.[54] Another instance where an insurer has a direct interest in the matter is when the insured is not defending the action.

In *Reliance Ins. Co. v. Superior Court*, plaintiffs sued a moving company (Campbell) for negligently mishandling their personal property.[55] Campbell was insured by Reliance Insurance Company (Reliance). At the time the lawsuit was filed, Campbell's corporate status was suspended and it could not defend any action against it. Reliance filed a motion for leave to intervene in the action. The court permitted intervention and held that Reliance had a direct and immediate interest in the underlying litigation because it may be required to satisfy a default judgment. Intervention was crucial to ensure the insurer's interests were adequately represented. *Reliance* noted that an insurer may intervene in an action prior to judgment or may move to set aside a default judgment if it has already been entered.

Intervention may also be necessary where the insurer did not participate in a settlement and wishes to set aside the judgment. Insurers should note that intervention will be impermissible where it has denied coverage and refused to defend its insured.[56] By denying coverage or refusing to defend the action, the insurer loses its right to control the litigation. In those instances where the insurer did not provide a defense to the insured, it may be bound by a settlement or judgment in the action reached without its participation.

Where an insurer may be subject to a default judgment in a third party action against the insured, it should make efforts to intervene or otherwise set aside the default judgment—otherwise, it will be bound by the default judgment. Insurers should make efforts to prophylactically defend claims subject to a reservation of rights so as not to be bound by default judgments. A robust reservation of rights letter will allow an insurer to vacate a default judgment so long as it tendered a defense under a reservation of rights. An insurer that defends under a reservation of rights does not forfeit its control over the litigation and may still intervene in proceedings conducted without its participation, provided it can show that the outcome directly affects its interests, as contemplated by section 387.

The right to intervention is especially critical in situations where the insureds is not actively defending the case. The moment an insurer accepts coverage or acknowledges a duty to defend, its interest in the case is not just financial, but also legal and immediate. In these circumstances, insurers should be prepared to intervene early, before default judgment is entered or settlement

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[53] *Reliance Ins. Co. v. Superior Court*, 85 Cal.App.4th 383, 385 (2000).

[54] *Gray v. Begley*, 182 Cal.App.4th 1509,1522 (2010).

[55] *Reliance*, 85 Cal.App.4th at 384.

[56] *Western Heritage Ins. Co. v. Superior Court*, 199 Cal.App.4th 1196, fn. 13 (2011).

finalized without its participation. Intervention allows insurers to protect its position, present defenses, and ensure that liability is not unfairly imposed without its input.

Insurers should exercise caution when denying coverage or refusing to defend because they thereby lose the right to control the litigation. In that case, insurers may find themselves bound by a judgment or settlement reached without its involvement, even if it disputes the outcome. California courts will not allow an insurer to intervene after the fact if it has already walked away from the defense. As such, insurers should make efforts to monitor the status of its insureds and any pending litigation against them. Additionally, an insurer should be prepared to demonstrate that its stake in the litigation involves not just financial exposure, but a direct and legally protectable interest in the outcome. Intervention is a powerful tool, but it must be used strategically and in accordance with insurer's coverage position.

5. **Special Jury Interrogatories**

In California, the loss of procedural tools like special interrogatories may be viewed as a form of material prejudice against insurers. In *Earle v. State Farm Fire & Cas. Co.*, the insureds sued their liability insurer for breach of contract after the company refused to reimburse them for defense costs in a prior lawsuit that included a defamation claim.[57] Although their insurance policy covered defamation, the insured did not notify the insurers until after a jury had already issued a multimillion dollar verdict against them. The insurer argued that the late notice caused actual prejudice—which would relieve them of liability—because it was deprived of the opportunity to defend or settle the case earlier. The court agreed with State Farm, finding that the insurer had suffered actual prejudice due to the late tender of the claim. Notably, the court observed that "had a special interrogatory been propounded to the jury" on whether the defamation was intentional or arose out of the insured's business operations, it is highly likely the jury would have answered yes—thereby triggering policy exclusions and relieving the insurer of its duty to indemnify.[58] Because no such interrogatory was presented, the insurer lost the opportunity to clearly establish that the claim fell outside the scope of coverage.

Prejudice is not limited to the inability to mount a defense, but also includes the inability to **preserve a clear record for coverage analysis.** When insurers receive late notice, it should document how the timing prevented them from requesting special interrogatories or influencing the verdict form. In coverage litigation, insurers can argue the absence of interrogatories creates ambiguities that should weigh against indemnity. This case illustrates why insurers should, whenever possible, request that the jury be given special interrogatories or a special verdict form to distinguish between covered and noncovered claims or damages. Doing so helps preserve the insurer's ability to litigate coverage issues after the underlying case concludes. Without such clarity, courts may be forced to interpret a general verdict, which can obscure whether the judgment was based on covered conduct or excluded acts.

[57] *Earle v. State Farm Fire & Cas. Co.*, 935 F.Supp. 1076, 1080 (N.D. Cal. 1996).

[58] *Id.* at 1082.

Special interrogatories and special verdict forms allow the jury to make specific findings on key issues that may determine whether a policy exclusion applies. To mitigate the risk of being bound by a general verdict, insurers should engage early and actively in the defense of the underlying case, particularly when defending under a reservation of rights. They should work closely with defense counsel – without interference with defense counsel's discretion to manage the defense (which would create a conflict) – to ensure that trial strategy includes efforts to separate covered from noncovered claims. This includes advocating for jury instructions or verdict forms that clearly identify the basis for liability. The *Earle* case serves as a reminder that the structure of the trial record can be just as important as the policy language itself.

6. **Post-Verdict Coverage Litigation**

California courts have consistently held that an insurer may litigate coverage defenses in subsequent proceedings. For example, in *Garamendi v. Golden Eagle Ins. Co.*, the court explained that an insurer notified of an action but refusing to defend is bound by the judgment only as to material findings of fact essential to the insured's liability and damages, but not as to coverage issues that were not adjudicated in the prior action.[59] Similarly, in *Howard v. American National Fire Ins. Co.*, the court emphasized that evidence in the underlying litigation focuses on liability, not insurance coverage, and does not necessarily dictate the scope of evidence in a later coverage action.[60]

An insurer may also challenge the validity of an underlying judgment if it was the product of fraud or collusion. In *Pruyn v. Agricultural Ins. Co.*, the court held that a nonparty insurer must be given a fair opportunity to litigate whether a settlement was unreasonable or the product of fraud or collusion between the insured and the claimant.[61] This principle was reiterated in *Wright v. Fireman's Fund Ins. Companies*, where the court refused to bind an insurer to a stipulated judgment that lacked evidentiary support and was entered without the insurer's consent, highlighting the potential for fraud and collusion.[62]

Conclusion

In conclusion, California's approach to mixed coverage claims is generally considered to be favorable to insurers, though it includes important protections for insureds. California law recognizes quasi-contractual rights as a mechanism to ensure fairness. These rights are not

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59 116 Cal. App. 4th 694, 717-18 (2004).

60 187 Cal. App. 4th 498, 514 (2010).

61 *Pruyn v. Agric. Ins. Co.*, 36 Cal. App. 4th 500, 515 (1995).

62 11 Cal. App. 4th 998, 1017-18 (1992).

based on the express terms of the insurance contract, but arise from equitable principles like unjust enrichment.

However, California courts have also emphasized that these quasi-contractual rights must be exercised in a manner that protects the insured's interests. For example, insurers may only seek reimbursement of non-covered claims when it has properly reserved its rights. This framework reflects California's attempt to balance insurer reimbursement rights with the insured's right to a defense and fair treatment, ensuring equitable remedies do not undermine the protective purpose of insurance.

New York

1. Preserving Apportionment or Coverage Issues

Under New York law, an insurer has a duty to defend an entire mixed action, including noncovered claims, if a single claim the complaint presents is covered.[63] An insurer may rely on a valid reservation of rights letter to preserve the option to later litigate or seek a determination of non-coverage.[64] An insurer who defends an action on behalf of an insured without reserving its rights may be estopped from disclaiming coverage.[65] To preserve its right to later argue about apportionment or coverage when both covered and noncovered claims are in play, an insurer must take deliberate and well-documented steps during the underlying litigation. New York law, particularly as illustrated in *K2 Investment Group, LLC v. American Guarantee & Liability Insurance Co.*, underscores the importance of procedural precision and contractual clarity in these situations.

In *K2*, the insurer initially refused to defend its insured in a legal malpractice action, which led to a default judgment.[66] The insured then assigned his rights to the plaintiffs, who sought to enforce the insurer's duty to indemnify. Although the insurer attempted to rely on policy exclusions to deny coverage, the court initially barred this defense due to the insurer's breach of its duty to defend. However, on re-argument, the Court of Appeals reversed course, holding that the insurer could still assert policy exclusions because there were unresolved factual questions about their applicability. The court reaffirmed that while an insurer who breaches the duty to defend cannot later challenge the findings of the underlying litigation, it may still invoke exclusions that are independent of those findings.

When an insurer does breach its duty to defend, it risks losing the ability to contest the facts established in the underlying case. However, this does not mean the insurer is entirely without recourse. Even after such a breach, insurers may still avoid indemnification if the exclusions they rely on do not require relitigating the underlying issues. To do so effectively, insurers must be strategic and precise: they need to carefully evaluate which exclusions are fact-dependent and which are not, and ensure that any coverage defenses they intend to preserve are clearly articulated and supported by the policy language.

Ideally, an insurer will fulfill its duty to defend, thereby preserving its ability to influence the course of litigation and maintain access to key tools—such as shaping the defense strategy, requesting

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[63] *Lombardi, Walsh, Wakeman, Harrison, Amodeo & Davenport, P.C. v. Am. Guar. And Liab. Ins. Co.*, 84 A.D.3d 1291, 1293 (3d Dept 2011).

[64] *Law Offices of Zachary R. Greenhill P.C. v. Liberty Ins. Underwriters, Inc.*, 128 A.D.3d 556, 559 (1st Dept 2015).

[65] *Federated Dept. Stores, Inc. v. Twin City Fire Ins. Co.*, 28 A.D.3d 32, 36 (1st Dept 2006).

[66] *K2 Inv. Grp., LLC v. Am. Guarantee & Liab. Ins. Co.*, 22 N.Y.3d 578, 584 (N.Y. 2014).

special verdict forms, and preserving coverage defenses. In essence, while breaching the duty to defend can limit an insurer's options, it does not eliminate them entirely. Insurers must tread carefully, relying on exclusions that stand apart from the underlying facts and ensuring that its policies and communications are clear, consistent, and legally sound.

2. Handling Noncovered Portions of Settlements

New York appellate case *American Wester Home Insurance Company v. Gjonaj Realty* offers important guidance for insurers handling settlements that involve both covered and noncovered claims. In *Gjonaj Realty*, the Second Department held that an insurer could not recover costs incurred defending noncovered claims, despite a finding of no duty to defend or indemnify and the insurer's reservation of rights.[67] The insurer denied coverage of a personal injury action because it was not notified timely. After the default judgment was vacated, the insurer agreed to defend and indemnify the underlying action, subject to a reservation of rights should the judgment be reinstated. When the default judgment against the insureds was reinstated, the insurer notified the insureds that it was denying coverage and reserving its right to recover any costs incurred defending the insureds in the underlying action. The appeals court agreed that there was no duty to indemnify the underlying action but denied the insurers right to seek reimbursement for defense costs.

The appeals court noted that several other New York appellate courts have held that an insurer may recover defense costs where there is a determination of no duty to indemnify, but declined to follow suit. Notably, the appeals court believes these cases did not address whether the right to reimbursement was "appropriate or authorized."[68] The court reasoned that the duty to defend is "exceedingly broad" and that a policy representing that it will provide the insured with a defense acts as a 'litigation insurance' on top of the contemplated liability coverage.[69] In a mixed action in New York, the duty to defend attaches to the entire action, irrespective of ultimate liability, so long as at least one claim arguably falls within the policy's covered events. Accordingly, allowing an insurance company to recover costs incurred defending the underlying action would effectively "make the duty to defend merely coextensive with the duty to indemnify."[70] The court articulated that an insurance policy is a contract between an insurer and insured and should be enforced as written. The insurance policy at issue did not contemplate that the insurer could recover costs of defending claims later determined to be noncovered.

New jurisprudence suggests that New York appeals courts view the duty to defend as all-encompassing, applying to both covered and noncovered claims. An insurer's reservation of rights

[67] *Gjonal Realty & Mgt. Co.*, 192 A.D.3d at 42.

[68] *Id.* at 37.

[69] *Id.* at 34 (citations omitted).

[70] *Id.* at 35.

alone is insufficient for recovering defense costs for noncovered claims.[71] When an insurer is faced with a settlement that resolves both covered and noncovered claims, the *Gjonaj* decision suggests that **contributing to the settlement and later seeking reimbursement for the noncovered portion is not a viable strategy.** The court made clear that unless the insurance policy explicitly provides for reimbursement, the insurer cannot retroactively carve out its contribution based on later determination of noncoverage.

If an insurer wants to preserve the ability to recoup payments for noncovered claims, it should expressly include recoupment language in the policy and reinforce it by reserving that right in writing once litigation ensues. New York does not recognize quasi-contract theories in the insurance context, as insurance policies are strictly governed by contract law. Courts prefer to interpret these agreements according to their express terms. Therefore, insurers should draft policy language with precision and clarity to ensure that all rights and obligations—such as the right to recoup defense costs—are explicitly stated and enforceable.

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3. Handling Noncovered Portions of Judgments

In New York, the duty to indemnify "is determined by the actual basis for the insured's liability to a third person ... and does not turn on the pleadings, but on whether the loss, as established by the facts, is covered by the policy."[72] In other words, the duty to indemnify attaches when the proven facts fall within the policy's coverage. In *Atlantic Mutual v. Terk Technologies*, the insurer denied coverage to its insured, arguing the claims did not fall within the scope of the policy's "advertising injury" coverage.[73] The court held that the insurer was not obligated to indemnify the defendant in a trademark infringement case because the defendant knowingly and fraudulently sold counterfeit goods. This conduct triggered the policy's exclusion for advertising injuries arising from the publication of false material made with knowledge of its falsity.

Terk Technologies demonstrates that coverage hinges on the actual facts established at trial, not just the nature of the claims alleged. In that case, although trademark infringement can be unintentional and potentially covered, the jury found that the insured had *knowingly and fraudulently* sold counterfeit goods. The factual finding is what triggered the policy exclusion.

This case underscores a critical point for insurers: when a verdict includes both potentially covered and clearly excluded claims, the insurer must closely examine the **factual findings in the judgment**—not just the pleadings—to determine whether any portion of the liability is clearly excluded under the policy. The focus should be on what the court or jury actually decided rather than on how the claims were framed in the complaint. By grounding coverage

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[71] *Id.* at 39 ("Plainly, a unilateral reservation of rights letter 'cannot create rights not contained in the insurance policy.'" (citations omitted)).

[72] *Atl. Mut. Ins. Co. v. Terk Techs. Corp.*, 309 A.D.2d 22, 28 (2003).

[73] *Id.* at 26.

decisions in the trial record, insurers can more effectively assert exclusions and avoid indemnifying losses that fall outside the scope of the policy. This approach is especially important in mixed-claim cases, where a careful reading of the verdict may reveal that the entire judgment is based on excluded conduct. To avoid further litigation, an insurer should take proactive steps to ensure that any damages awarded in a trial are clearly allocated between covered and noncovered claims.

4. Intervention in the Underlying Case

Even when denied, motions to intervene can offer insurers meaningful strategic value by preserving their rights and demonstrating proactive efforts to protect coverage interests. The Second Circuit's decision in *Uvino v. Harleysville Worcester Insurance Company* illustrates that, although courts may be wary of an insurer's involvement in an underlying trial potentially complicating or prejudicing the insured's defense, such participation can also be viewed as a proactive measure that will benefit the insured in the long run. In *Uvino*, a family sued its construction manager (JBI) for performing work outside the agreement without authorization, and for damage to their property.[74] The insurer (Harleysville) provided a commercial general liability policy to JBI and agreed to defend it in the underlying action subject to a reservation of rights. Before trial, the insurer requested to intervene and asked the court to submit special interrogatories to the jury. The goal was to ask the jury distinguish between two types of damages: those "related to the repair and replacement of [JBI's] faulty work," which Harleysville claimed was not covered by the policy, and "damages to other property," which might be covered.[75] The court ultimately denied the insurer's motion to intervene, although it allowed the insurer to reserve its right to contest coverage, and the jury awarded substantial damages to the family.

The family sought declaratory relief arguing that the damages awarded by the jury in the underlying action were covered by the policy. The court declined to shift the burden of allocating costs from the family to the insurer, and granted the insurer's motion for summary judgment. The court found that the family had failed to present "an intelligible method of separating those damages awarded to them by the jury that the Harleysville policy covers and those that it does not."[76] The appeals court affirmed, holding that: (1) the insurer made clear in its motion to intervene that it believed most claims were noncovered by the policy; (2) the insured objected to the use of special interrogatories to allocate damages and that objection was sustained; (3) the family took no position on the insurer's motion to intervene; (4) the insurer reserved its right to contest coverage in subsequent proceedings; and (5) the family had ample opportunity to present evidence distinguishing between covered and noncovered claims. Accordingly, both the family and the insured were on notice of the allocation issue. The court granted summary

[74] *Uvino v. Harleysville Worcester Ins. Co.*, 708 Fed. Appx. 16, 18 (2d Cir. 2017).

[75] *Id.* at 19.

[76] *Id.*

judgment to Harleysville, and the insurer was excused entirely from indemnifying the claim, even though some underlying claims were potentially covered by the policy.

Uvino demonstrates that intervention can be used not just to control the defense, but to address coverage issues. It also makes it clear that notice does not require a formal warning letter, but can be established through litigation conduct, such as motions, objections, and reservation of rights. Insurers who clearly reserve rights, seek to intervene, and advocate for special verdict forms can significantly limit indemnity exposure. Courts may find no coverage if damages aren't properly allocated—even when some claims are potentially covered.

5. **Special Jury Interrogatories**

In mixed coverage claims, **New York law requires the insured to establish both entitlement to coverage and the allocation of damages to covered claims.** However, the burden may be shifted to the insurer under certain circumstances. If the insurer fails to adequately inform the insured about the importance of obtaining a special verdict, courts may allow the insured to proceed to summary judgment without a precise allocation of covered versus noncovered claims. Although New York law offers limited guidance on the use of special interrogatories for allocating damages, *Uvino* suggests that policyholders may bear the burden of allocating damages between covered and noncovered claims—especially when an insurer's failed attempt to intervene and request special interrogatories effectively puts the insured on notice of the allocation issue.

The holding in *Uvino* is highly fact-specific and does not foreclose the possibility that, under different circumstances, the burden of allocating damages between covered and noncovered claims could fall on the insurer. The court noted that even a denied motion to intervene or a rejected request for special interrogatories may still be sufficient to alert the parties to the existence of an allocation dispute. Therefore, insurers should attempt to **formally request special interrogatories** or special verdict forms in underlying litigation to ensure damages are clearly allocated. Even if the court denies the motion, the insurer's effort to obtain allocation can help preserve its position in later coverage litigation. Additionally, insurers should notify the insured and all parties early about the importance of allocating damages and the potential consequences of a general verdict. Courts may consider whether the insurer made its interest in allocation "adequately known" when determining whether the burden should shift. If a general verdict is returned in the underlying action, insurers should be prepared to argue that no indemnity is owed unless the insured can prove allocation.

6. **Post-Verdict Coverage Litigation**

Insurers retain meaningful rights in declaratory judgment actions post-judgment, particularly regarding exclusions and allocation. The decision in *K2 Investment Group* clarifies that an insurer may still litigate the applicability of policy exclusions in a DJ action, especially if those exclusions involve unresolved factual questions. However, this right is not unlimited. Under the doctrine of res judicata, an insurer cannot relitigate issues that were

actually decided in the underlying action[77]—particularly if the insurer breached its duty to defend. If an underlying judgment resolves factual issues, those findings may be binding on an insurer, even if they are central to the application of a policy exclusion. This rule protects the insured from being forced to relitigate liability facts that were already adjudicated. Despite the limits imposed by res judicata, insurers can still litigate: (1) the legal interpretation of policy exclusions, as long as they don't contradict factual findings from the underlying case; (2) allocation of damages between covered and noncovered claims, if the judgment or settlement does not specify this; and (3) reimbursement, if the insurer defended under a reservation of rights or contributed to a settlement involving noncovered claims.

To avoid losing the ability to litigate post-judgment, insurers should:

- **Defend under a reservation of rights** to preserve flexibility;
- **Act quickly** to file a DJ action when coverage is in dispute;
- **Avoid waiving defenses** by refusing to defend without a strong legal basis;
- **Respect the finality of adjudicated facts** if they failed to defend;
- And **focus post-judgment litigation on legal, not factual issues.**

Conclusion

New York takes a contract-centric approach to insurance coverage disputes in the context of mixed coverage claims. Unlike California, which permits insurers to seek reimbursement for non-covered claims under quasi-contractual theories like unjust enrichment, New York courts are generally reluctant to imply such rights. Instead, they emphasize the express terms of the insurance policy, enforcing them strictly. In mixed claims, New York law obligates insurers to defend the entire action if any claim is even arguably covered. However, reimbursement for defense or settlement costs related to non-covered claims may not be allowed unless explicitly provided for in the policy. This framework tends to be more favorable to insureds, as it limits insurer's ability to recoup costs and reinforces the protective nature of the duty to defend.

[77] *K2 Inv. Grp., LLC v. Am. Guarantee & Liab. Ins. Co.*, 22 N.Y.3d 578, 585 (N.Y. 2014).

Florida

1. Preserving Apportionment or Coverage Issues

To preserve its right to later argue apportionment or coverage when both covered and noncovered claims are in play during an underlying case, a Florida insurer must clearly and proactively notify the insured of the need for damage allocation, particularly the availability and advisability of a special verdict or jury interrogatories. Failing to do so can result in the burden of apportionment shifting to the insurer.

An Eleventh Circuit case, *QBE Specialty Ins. Co. v. Scrap Inc*, illustrates this rule. The insurer, QBE, agreed to defend the insured, Scrap, in the underlying nuisance lawsuit and to provide counsel under a reservation of rights.[78] Generally, the insured bears the burden of proving what part of a judgment falls within coverage, but the insurer can lose this protection through inaction. The court noted that "[u]nder Florida law, the party claiming insurance coverage has the initial burden to show that a settlement or judgment represents damages that fall within the coverage provisions of the insurance policy."[79] If the insured cannot distinguish noncovered from the covered claims, the insured's claim for indemnification will typically fail.[80] The responsibility for apportioning damages in a general verdict may shift to the insurer if the insurer failed to properly inform the insured about the importance and availability of a special verdict to separate covered and noncovered claims.[81]

Regarding the timing, an insurer must comply with the Claims Administration Statute written notice of its reservation of rights to the insured within 30 days after the insurer knew or should have known of the coverage defense.[82]

In addition to preserving apportionment through timely and clear notice to the insured about the need for a special verdict, an insurer must also ensure that it is acting in good faith and not contributing to any breakdown in cooperation that may affect its ability to later deny coverage. As the Eleventh Circuit emphasized in *Mid-Continent Cas. Co. v. American Pride Building Co., LLC*, an insurer may deny coverage based on lack of cooperation only if that

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78 *QBE Specialty Ins. Co. v. Scrap Inc*., 806 F. App'x 692, 696 (11th Cir. 2020) (quoting *U.S. Concrete Pipe Co. v. Bould*, 437 So. 2d 1061, 1065 (Fla. 1983).

79 *Id*.

80 *Id*. (citing *Trovillion Constr. & Dev., Inc. v. Mid-Continent Cas. Co.*, 2014 WL 201678, at *8).

81 *Id*. (citing *Duke v. Hoch*, 468 F.2d 973, 976–83 (5th Cir. 1972)).

82 Fla. Stat. Ann. § 627.426.(2)(a).

failure constitutes a material breach that substantially prejudices the insurer's ability to defend the claim. [83]

The court held that "an insurer may deny coverage and avoid payment of compensation to the victim of the insured's tort where the insured has been guilty of lack of cooperation" [84] However, "[n]ot every failure to cooperate will release the insurance company. Only that failure which constitutes a material breach and substantially prejudices the rights of the insurer in defense of the cause will release the insurer of its obligation to pay."[85] *Mid-Continent Cas. Co. v. Am. Pride Bldg. Co., LLC* explains that what constitutes a material breach sometimes depends on finding of the facts so a motion for summary judgement is not always appropriate. [86] In this case, the insurer argues that it has no duty to indemnify because the insured violated the terms of the insurance policy in settling the underlying action without the insurer's participation and consent.[87] The Eleventh Circuit agreed with the circuit court that "[a]n insured may reject a conditional defense after the initial offering if the insurer changes the terms of the conditional defense in a material way."[88] Furthermore, an insurer must exercise diligence and good faith in eliciting insured's cooperation and comply with the policy's terms and conditions in good faith in order to avoid its obligations to pay. [89]

2. Handling Noncovered Portions of Settlements

Florida courts have not addressed an insurer's right to reimbursement of noncovered settlement costs, but the state's cases on defense-cost reimbursement suggest settlement-cost reimbursement is unlikely to be allowed unless there is a total lack of coverage or there is express policy language or an agreement: Florida only allows insurers to obtain

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[83] *Mid-Continent Cas. Co. v. Am. Pride Bldg. Co., LLC*, 601 F.3d 1143, 1149–50 (11th Cir. 2010) (quoting *Ramos v. Nw. Mut. Ins. Co.*, 336 So.2d 71, 75 (Fla.1976)).

[84] *Id*.

[85] *Id*.

[86] *See id*. (explaining that "whether the failure to cooperate is so substantially prejudicial as to release the insurance company of its obligation is ordinarily a question of fact . . . under some circumstances, particularly where the facts are admitted, it may well be a question of law.").

[87] *Id*. at 1150.

[88] *Id*.

[89] *Davis v. Great Northen Insurance Company*, No. 23-10137, 2024 WL 2815135, at *5 (11th Cir. June 3, 2024) (quoting *First Am. Title Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 695 So. 2d 475, 476–77 (Fla. Dist. Ct. App. 1997)).

reimbursement of defense costs where the insurer *never had a duty to defend* from the beginning of the case.[90]

Beyond the reimbursement question, Florida law is well-settled in that the party seeking coverage for a settlement has the burden of proving that the settlement is covered under the insurance policy.[91] "If a lawsuit contains both covered and non-covered claims and damages, 'Florida law clearly requires the party seeking recovery ... to allocate any settlement amount between covered and noncovered claims.'"[92] The insured's inability to allocate precludes recovery against the insurer.[93]

In *Around the Clock*, the settlement agreement was a global resolution and mutual release of all disputes. The insured, Around the Clock, and the plaintiff agreed to the lump-sum settlement payment in full settlement and satisfaction of claims relating to Davis's lawsuit, including all claims raised, or claims that could have been raised. The agreement did not allocate any portion of the lump-sum settlement payment to any specific claims or causes of action. Moreover, Around the Clock acknowledged that it was incapable of allocating the lump-sum settlement payment to any specific claims covered under the settlement agreement. Accordingly, because Around the Clock was incapable of allocating the lump-sum settlement payment to any specific claims covered by the settlement agreement, the court held Around the Clock must prove that each claim covered under the settlement agreement is also covered under the terms of the policy.[94] If any one of the claims covered

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[90] *Pennsylvania Lumbermens Mut. Ins. Co. v. Indiana Lumbermens Mut. Ins. Co*., 43 So. 3d 182, 187 (Fla. Dist. Ct. App. 2010); *Jim Black & Assoc., Inc. v. Transcontinental Ins. Co.,* 932 So. 2d 516 (Fla. 2d DCA 2006); *Colony Ins. Co. v. G&E Tires & Serv., Inc.,* 777 So. 2d 1034 (Fla. 1st DCA 2000).

[91] *Around the Clock A/C Serv., LLC v. Travelers Cas. & Sur. Co. of Am.*, No. 20-62529-CIV, 2022 WL 678799, at *7 (S.D. Fla. Jan. 31, 2022); *Horn v. Liberty Ins. Underwriters, Inc.*, 391 F. Supp. 3d 1157, 1164 (S.D. Fla. 2019).

[92] *Around the Clock*, 2022 WL 678799, at *7; *Horn*, 391 F. Supp. 3d at 1164; *Bradfield v. Mid-Continent*, 143 F. Supp. 3d 1215, 1245 (M.D. Fla. 2015).

[93] *Around the Clock*, 2022 WL 678799, at *7; *Horn*, 391 F. Supp. 3d at 1164; *see Highlands Holdings, Inc. v. Mid-Continent*, 687 Fed. Appx. 819, 820 (11th Cir. 2017) (holding that the insurer owed no duty to indemnify its insured for a settlement agreement because the insured could not prove how much it paid to settle any claims covered under its insurance policy.); *see also J.B.D. Constr.*, 571 Fed. Appx. at 928 n.7 ("Under Florida law, [the insured] has the burden of allocating the settlement amount between covered and uncovered claims and the inability to do so precludes recovery."); *Keller Indus. v. Empl. Mut. Liab. Ins. Co.*, 429 So. 2d 779, 780 (Fla. DCA 1983) (affirming the lower court's refusal to award damages under the insurance contract based on a settlement entered into by the insured because "as the party claiming coverage, [the insured] had the burden, which it failed to carry, to apportion damages and show that the settlement, or portions thereof, represented costs that fell within the coverage provisions of the policy.").

[94] *Around the Clock*, 2022 WL 678799, at *7 (citing *Highland Holdings*, 687 Fed. Appx. at 820; *J.B.D. Constr.*, 571 Fed. Appx. at 928 n.7; *Horn*, 391 F. Supp. 3d at 1164).

under the settlement agreement is not also covered under the policy, the court ruled, the plaintiff is precluded from recovery.[95]

Because the settlement agreement resolved the underlying action in its entirety, including these uncovered claims, and did not allocate the settlement payment, the insured failed to satisfy its burden of proving coverage for the settlement and therefore was not entitled to any recovery from its insurer.[96]

3. Handling Noncovered Portions of Judgments

Florida courts have also addressed the preclusive effect of judgments in the underlying action on the insurer's duty to indemnify. In *Jones v. Florida Ins. Guar. Ass'n*, the court held that when an indemnitor (there, a state-created guaranty association standing in for an insolvent insurer) has notice of a suit and an opportunity to defend, a judgment rendered against the indemnitee is conclusive as to all material questions determined in the judgment, provided there is no fraud or collusion. *Jones v. Florida Ins. Guar. Ass'n*, 908 So. 2d 435 (2005). This principle underscores the importance of the insurer's participation in the defense of the underlying action to protect its interests.

Florida law permits insurers to seek declaratory judgments to resolve disputes over their duty to indemnify, even when factual determinations are required. In *Higgins v. State Farm Fire and Cas. Co.*, the Florida Supreme Court held that declaratory judgment actions are appropriate to determine an insurer's indemnity obligations, including factual issues necessary to resolve coverage disputes. The court emphasized that declaratory actions can provide clarity and avoid protracted litigation over coverage issues.[97]

4. Intervention in the Underlying Case

Florida courts have consistently held that an insurer must demonstrate a direct and immediate interest in the litigation to justify intervention. In *Houston Specialty Insurance Company v. Vaughn*, the court affirmed the denial of the insurer's motion to intervene, reasoning that the insurer's interest was speculative and contingent upon the entry of a judgment against the insured. The court explained that the insurer's interest would only materialize if a judgment was entered and subsequent legal actions were initiated to enforce the judgment against the insurer.[98]

Similarly, in *Lexington Insurance Company v. James*, the court emphasized that a contingent interest, such as the possibility of owing policy limits based on an adverse judgment, does not meet the standard for intervention. The court noted that allowing intervention on such

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95 *Around the Clock*, 2022 WL 678799, at *7.

96 *Id.* at *8.

97 *Higgins v. State Farm Fire & Cas. Co.*, 894 So. 2d 5, 9 (Fla. 2004).

98 261 So. 3d 607, 611 (Fla. Dist. Ct. App. 2018).

grounds would undermine Florida's nonjoinder statute, § 627.4136(2), which prohibits third parties from having an interest in liability insurance policies before a judgment is entered against the insured.[99]

The Florida Supreme Court in *Union Central Life Insurance Co. v. Carlisle* clarified that intervention requires a meaningful opportunity for the insurer to assert and protect its interests, but the insurer cannot interfere with or participate in the trial between the claimant and the tortfeasor.[100] The court held that intervention is appropriate when the insurer has a direct and immediate interest in the apportionment or distribution of judgment or settlement funds, ensuring the insurer has standing to appeal adverse decisions.[101]

5. Special Jury Interrogatories

Yes, an insurer probably should request that the jury be given special interrogatories or a special verdict form to separate covered from noncovered claims. The Eleventh Circuit affirmed a summary judgment for an insurer, when it informed the insured to "request a special verdict, differentiating covered damages from noncovered damages, and that if it did not, the failure to seek allocation could result in forfeiture of coverage for all damages."[102]

This case involves the insured, Scrap, a Florida scrap-metal company, and the insurer QBE.[103] Scrap appealed to hold QBE liable for indemnification in the underlying case.[104] It was a nuisance action brought by residents affected by Scrap's metal shredding facility, and Scrap was held liable for $750,000.[105] These policies covered damages for "bodily injury" or "property damage" during the time and territory covered, but the policies also included a pollution exclusion clause.[106] QBE was not a party to this lawsuit but agreed to defend Scrap under a reservation of rights.[107] Throughout the proceeding, QBE told Scrap in multiple letters explicitly that Scrap would have to request a special verdict.[108] QBE also twice attempted to intervene in the underlying suit for the purpose of assisting with the preparation

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99 295 So. 3d 367, 372 (Fla. Dist. Ct. App. 2020).

100 593 So. 2d 505, 507 (Fla. 1992).

101 *Id*.

102 *QBE,* 806 Fed. Appx. at 696 (11th Cir. 2020).

103 *Id*. at 694.

104 *Id*.

105 *Id*.

106 *Id*.

107 *Id*.

108 *Id* at 696.

of special-interrogatory verdict forms.[109] Though the court has denied QBE's motion to intervene, the court upheld that the insurer was relieved of the indemnification liability because the insured failed to secure the special interrogatories or a special verdict form after the insurer met its burden to notify the insured. [110]

6. Post-Verdict Coverage Litigation

An insurer can pursue a post-verdict DJ action to litigate damages, applicability of exclusions, or reimbursement if there is a justiciable controversy and not only an advisory opinion.

In *Higgins v. State Farm Fire & Cas. Co.*, the Florida Supreme Court answered a certified question and held that Florida's declaratory judgment statutes authorize an insurer to file a DJ action even when the coverage determination depends on resolving disputed facts. The court explained: "We agree with the Fourth District that sections 86.011(2), 86.051, 86.071, and 86.101 support the conclusion that an insurer may pursue a declaratory action which requires a determination of the existence or nonexistence of a fact upon which the insurer's obligations under an insurance policy depend." [111]

This means an insurer is not barred from bringing a DJ action simply because it would require a court to make factual findings. For example, whether the conduct at issue was intentional or accidental, or whether particular damages fall within an exclusion. *Higgins* confirms that the declaratory judgment procedure is a proper mechanism to clarify the insurer's obligations post-verdict or post-settlement, including issues like apportionment between covered and noncovered claims, or the enforceability of exclusions and reservations of rights.

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109 *Id*.

110 *Id* at 697.

111 *Higgins v. State Farm Fire & Cas. Co*., 894 So. 2d 5, 12 (Fla. 2004).

Washington

1. Preserving Apportionment or Coverage Issues

To preserve its right to later argue apportionment or coverage when both covered and noncovered claims are in play during an underlying case, a Washington insurer must (1) thoroughly investigate; (2) retain competent defense who represents only the insured as the client; (3) fully inform the policyholder, especially regarding settlement offers; and (4) refrain from favoring its monetary interest over the policyholder's financial risk.[112]

A Washington Supreme Court case, *Tank v. State Farm Fire & Cas. Co.*, explained that Washington imposed "enhanced duties" on both reserving insurers and their dependent counsel which "mandate an even higher standard" than the duty of good faith and fair dealing or the Canons of Ethics and threaten both with civil liability for a failure to adhere to this higher standard.[113] Moreover, defense counsel must: (1) not allow the insurer to influence his or her professional judgment; (2) make full and ongoing disclosure to the insured, including (A) that potential conflicts of interest must be fully disclosed and resolved in favor of the insured; (B) all information relevant to the defense must be disclosed; and (C) all offers of settlement must be disclosed.[114] This shows that insurer must avoid affecting the defense counsel to satisfy the requirement when preserving its rights.

Moreover, regarding a reservation of rights agreements, the court held that

> A reservation of rights agreement is not a license for an insurer to conduct the defense of an action in a manner other than [the manner in which] it would normally be required to defend. The basic obligations of the insurer to the insured remain in effect.[115]

This insurer is held to the same high standard because, under a reservation-of-rights defense, the insured may ultimately bear the financial burden of any settlement or judgment. As a result, the insured must retain the right to control settlement decisions. To exercise that right meaningfully, the insured must be fully informed of all settlement-related activity, including any offers or rejections made by the claimant or the insurer.[116]

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112 *Tank v. State Farm Fire & Cas. Co.*, 105 Wash. 2d 381, 383 (1986).

113 *Id.*

114 *Id.*

115 *Id.* (quoting *Weber v. Biddle*, 4 Wash. App. 519, 524, 483 P.2d 155, 159 (1971)).

116 *Id.* at 389.

2. Handling Noncovered Portions of Settlements

There is no case that address the reimbursement issue in settlements, but case law regarding defense-cost reimbursement implies that insurers likely cannot recover indemnity payments made for noncovered claims as part of a settlement. In *National Surety Corporation. v. Immunex Corporation.*, the Washington Supreme Court held that even if an insurer defended under a reservation of rights, it cannot retroactively recoup defense costs once the court has determined the policy didn't cover the claims, unless the policy explicitly allows it.[117]

One way for the insurer to recoup the cost for noncovered claims is to affirmatively include the right to reimbursement of defense costs in the insurance policy. No binding authority has yet held on this issue, but Washington District Court has held that such explicit provisions in the insurance policy agreement are enforceable. In *Massachusetts Bay Insurance Company v. Walflor Industries, Inc.*, the United States District Court for the Western District of Washington held that the Defense Cost endorsement should be enforced as written and granted the plaintiff insurer summary judgment on its right to be reimbursed for noncovered claims.[118] The court explained that "unlike AS 21.96.100, which the Alaska Supreme Court specifically read as prohibiting a reimbursement provision, Tank does not prohibit an insurer from including such a provision in a business owners policy. Thus, the court finds no basis for invalidating the endorsement on public policy grounds and concludes that Massachusetts Bay is entitled to recoup the defense costs it paid in the Underlying Lawsuit."[119]

The language in the insurance policy that allows for this reimbursement is "[i]f we initially defend an insured or pay an insured's defense but later determine that none of the claims, for which we provided a defense or defense costs, are covered under this insurance, we have the right to reimbursement for the defense costs we have incurred."[120] A Washington insurer should include a similar provision in its policy to receive this protection that is otherwise unavailable under a reservation of rights defense.

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117 *Nat'l Sur. Corp. v. Immunex Corp.*, 176 Wash. 2d 872, 875 (2013) ("The question in this case is whether the insurer may unilaterally condition its reservation of rights defense on making the insured absorb the defense costs if a court ultimately determines there is no coverage. We answer no. We recognize, however, that an insurer may avoid or minimize its responsibility for defense costs when an insured belatedly tenders a claim and the insurer demonstrates actual and substantial prejudice as a result.")

118 *Massachusetts Bay Ins. Co. v. Walflor Indus., Inc.*, 383 F. Supp. 3d 1148, 1169 (W.D. Wash. 2019).

119 *Massachusetts Bay Ins. Co.* 383 F. Supp. 3d at 1169 (citing *Tank v. State Farm Fire & Cas. Co.,* 105 Wash. 2d 381, 383, 715 P.2d 1133, 1135 (1986)).

120 *Id.* at 1154.

3. Handling Noncovered Portions of Judgments

"An insurance company has the duty to indemnify if the insurance policy ***actually*** covers the insured," as opposed to the duty to defend, which "arises if the insurance policy ***conceivably*** covers the insured." *Robbins v. Mason Cnty. Title Ins. Co.*, 462 P.3d 430, 435 (Wash. 2020) (emphasis in original).

A crucial Washington nuance, however, is that an insurer who mishandles its defense obligations can lose the ability to contest coverage altogether. If an insurer unreasonably refuses to defend a covered claim, or defends but acts in bad faith, Washington courts may impose the penalty of coverage by estoppel. Under the doctrine of coverage by estoppel, the insurer is estopped from denying coverage for the underlying liability, even if portions of the claim would ordinarily fall outside the policy. The Washington Supreme Court's landmark decision in *Truck Ins. Exchange v. VanPort Homes, Inc*. held that an insurer that breaches the duty to defend in bad faith is liable for the entire judgment or settlement that results – the insurer cannot later parse out what was uncovered.[121] In *VanPort Homes*, the insurer had wrongfully refused to defend a construction lawsuit; as a result, it was bound by the outcome and "estopped from denying coverage" for the insured's liability.[122]

This strong medicine reinforces the public policy in Washington that insurers must handle defense and coverage decisions in good faith, with equal consideration of the insured's interests. In summary, when a judgment includes both covered and non-covered elements, a diligent insurer that has honored its defense duty can insist on paying only the covered portion, but an insurer that breaches its duties may find itself on the hook for the entire judgment by operation of law.

4. Intervention in the Underlying Case

In Washington, insurer intervention in an underlying liability action, particularly when there are both covered and noncovered claims, should be approached with significant caution. Washington is known to be a pro-policyholder jurisdiction, and its courts are especially wary

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[121] *Truck Ins. Exch. v. Vanport Homes, Inc.,* 58 P.3d 276, 281 (Wash 2002) ("It is unnecessary for us to reach the issue of whether or not coverage was excluded under specific policy provisions because we hold that an insurer that, in bad faith, refuses or fails to defend is estopped from denying coverage. It is well established that where an insurer has a duty to defend an action and the insurer refuses to defend, the insurer is bound by the decision of the trier of fact regarding issues necessarily decided in the litigation.").

[122] *Id*.

of actions by insurers that may compromise the insured's defense.[123] This means that insurers should consider intervening only when a compelling interest requires it, such as where the verdict form needs clarification to preserve apportionment issues. Even then, any intervention must be handled delicately to avoid allegations of bad faith.[124]

The Washington Supreme Court has made clear that insurers risk significant consequences if they interfere with the insured's defense while coverage issues remain unresolved. Specifically, in *Mutual of Enumclaw Insurance Co. v. Dan Paulson Construction, Inc.*, the court found that the insurer acted in bad faith by attempting to litigate coverage issues that overlapped with the insured's liability defense.[125] The insurer's effort to establish that certain defects were excluded from coverage due to the insured's work directly undermined the insured's position in an ongoing arbitration over liability.[126] This dual-track strategy was seen as prejudicing the insured's defense, thereby constituting bad faith.[127]

The court explained: "MOE sought to establish which claimed defects were excluded from coverage because they resulted from work performed by DPCI. Simultaneously, DPCI was contesting liability for any defects in the underlying arbitration action. To the extent that MOE prevailed, it would have directly prejudiced DPCI's position in the arbitration, clearly an act of bad faith."[128]

Ultimately, the court concluded that MOE's conduct—intervening in a way that interfered with its insured's defense—created a presumption of harm. Because MOE failed to rebut this presumption, it was estopped from denying coverage: "[h]ere we hold only that, in this third-party reservation of rights situation in which MOE's bad faith interfered in its defense of DPCI, MOE did not rebut the presumption of harm. As a result, the Martinellis prevail on their bad faith claim, and MOE is estopped from denying coverage."[129]

This case illustrates that in Washington, insurer intervention in the underlying case can backfire if it jeopardizes the insured's defense strategy. Intervention should only be considered when there is a clear, justified need, and even then, only in a way that does not interfere with the insured's ability to contest liability.

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123 Franklin D. Cordell, Michael A. Hamilton, James W. Bryan & Suzan F. Charlton, *Navigating Disputes Over Allocation Between Covered and Uncovered Claims*, 57 Tort Trial & Ins. Prac. L.J. 97, 112 (Winter 2022).

124 *Id*.

125 *Mutual of Enumclaw Ins. Co. v. Dan Paulson Const., Inc*., 169 P.3d 1, 9–10 (Wash. 2007) (citing Thomas V. Harris, Washington Insurance Law § 14.2, at 14–4 (2d ed.2006)).

126 *Id*.

127 *Id*.

128 *Id*.

129 *Id*. at 13.

5. Special Jury Interrogatories

While there is no binding authority that has held on the issue, *Mutual of Enumclaw Insurance Co.* suggests that an insurer desiring interrogatories on coverage issues should be especially careful to seek them in a manner that does not prejudice the insured or interfere in its defense. [130]

6. Post-Verdict Coverage Litigation

Washington law allows insurers to litigate the allocation of damages between covered and noncovered claims, even after a settlement or judgment, provided the coverage question does not turn on the same facts resolved in the underlying case. In *Mutual of Enumclaw Ins. Co. v. T&G Const., Inc.*, the Washington Supreme Court held that while an insurer is bound by the factual findings of a judicially approved settlement deemed reasonable, it may still contest which damages are covered and which are not. This is because insurance policies often provide coverage for some types of damages but exclude others. The court remanded the case to determine whether specific policy exclusions applied to the damages at issue. [131]

Similarly, in *Polygon Northwest Co. v. American Nat'l Fire Ins. Co.*, the court emphasized that insurers are not obligated to pay for losses they did not contract to insure. The allocation of settlement obligations must align with the specific terms of the insurance policy, and courts must avoid imposing liability for noncovered losses. [132]

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130 *Mutual of Enumclaw Ins. Co. v. Dan Paulson Const., Inc.,* 169 P.3d 1, 9–10 (Wash. 2007).

131 165 Wash. 2d 255, 272 (2008).

132 143 Wash. App. 753, 771-72 (2008).