THINK INSURANCE:
PRACTICAL TIPS FOR MAXIMIZING TRADITIONAL LIABILITY AND PROPERTY INSURANCE CLAIMS

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THINK INSURANCE: *PRACTICAL TIPS FOR MAXIMIZING TRADITIONAL LIABILITY AND PROPERTY INSURANCE CLAIMS*

I. Introduction.

Every year, American businesses invest millions of dollars in premiums to buy insurance coverage. There are as many different kinds of insurance products as there are risks. For the sake of simplicity, most insurance benefits can broadly be classified as either "first party" insurance or "third party" insurance. "First party" insurance generally refers to policies or payments that directly benefit the insured. Health insurance or property insurance benefits, for example, are paid to the insured or for services or to replace assets and income that directly benefit the policyholder. "Third party" insurance refers broadly to policies or payments that benefit third parties, liability insurance being the most common example.

In the current economic environment, companies of all shapes and sizes are looking for ways to maximize value and reduce costs. When it comes to insurance, corporate policyholders may attempt to reduce costs by buying less coverage or agreeing to more restrictive terms. Alternatively, when contractual obligations and prudent risk management practices do not permit this kind of cost cutting, sophisticated risk managers and in-house counsel will seek to add value by increasing recoveries on claims under existing policies.

Whether pursuing coverage for a first-party loss resulting from a hurricane or attempting to recover defense costs under a liability policy, there are fundamental best practices with which all insureds should be familiar. Understanding these basic concepts outlined in this article will provide the best opportunity to maximize claim recovery and to realize the greatest return on the investment corporate policyholders make annually in traditional liability and commercial property insurance policies.

II. Increasing Recovery For Third-Party Claims Under Liability Insurance.

A. What Is Liability Insurance?

Liability insurance is lawsuit insurance. Just as lawsuits may involve any number of claims and types of damages, there are a variety of different kinds of liability insurance policies insuring diverse risks. Liability insurance generally provides two distinct benefits: (1) the "duty to defend," *i.e.*, the duty to pay attorneys' fees and other defense costs incurred in connection with covered claims or suits; and (2) the "duty to indemnify," *i.e.*, the duty to pay damages awarded in judgments or arbitration awards or agreed to in settlements.

Under Texas law, the duty to defend is determined by comparing the allegations against the insured with the terms of the insurance policy. *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 307 (Tex. 2006). If even a single allegation creates the potential that the insured will be subject to covered damages, the insurer is obligated to defend the entire suit. *See generally Heyden Newport Chem. Corp. v. S. Gen. Ins. Co.*, 387 S.W.2d 22, 23–25 (Tex. 1965). Unlike the "duty to defend," the "duty to indemnify" requires the insurer to pay covered "damages," *i.e.*, settlements, awards and/or judgments against the insured. Unlike the "duty to defend," the "duty to indemnify" is determined by the actual facts establishing the insured's liability for covered damages. *See, e.g.*, *Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co.*, 279 S.W.3d 650, 656 (Tex. 2009) ("[F]acts actually established in the underlying suit control the duty to indemnify."). The "duty to defend" and the "duty to indemnify," therefore, may each exist independently of the other. *D.R. Horton—Texas, Ltd. v. Markel Int'l Ins. Co.*, 2009 Tex. LEXIS 1042, at *9 (Tex. Sept. 8, 2009).

While some types of liability insurance, including errors and omissions ("E&O"), directors and officers liability ("D&O"), employment practices liability ("EPLI") and fiduciary liability insurance may not contain an express "duty to defend," subject to the policies' terms and conditions, such insurers nonetheless are generally obligated to pay "loss," including defense costs, judgments and settlements for covered claims.[1] Here is a short summary of some common forms of liability insurance and the types of claims covered by each.

[1] Even absent an express duty to defend, the insurer's obligation to advance or reimburse the insured for defense costs is determined on the basis of the "allegations" pled against the insured and the terms of the policy. *See, e.g.*, *Basic Energy Servs., Inc. v. Liberty Mut. Ins. Co.*, 655 F. Supp. 2d 666, 673–75 (W.D. Tex. 2009). Defense counsel, therefore, must always consider and, where appropriate, pursue coverage for attorney's fees and other defense costs incurred in defending the insured client.

Commercial General Liability Insurance. Most businesses carry commercial general liability ("CGL") insurance, which generally provides coverage for amounts the insured becomes legally obligated to pay as damages because of (1) property damage; (2) bodily injury; and/or (3) an assortment of "offenses" broadly defined as "personal and advertising injury," including false arrest/imprisonment; malicious prosecution; wrongful eviction, wrongful entry, or invasion of the right of private occupancy; libel/slander/business disparagement; invasion of privacy; misappropriation of advertising ideas; and infringement of copyright, title or slogan.[2] Importantly, under many CGL policies, amounts paid by the insurer to defend an insured do not exhaust the policy's limit of liability.

Professional Liability/Errors & Omissions Liability Insurance. Professional liability or E&O policies generally insure amounts the insured becomes legally obligated to pay as damages because of a claim for "wrongful acts," which may include acts, errors, omissions, breaches of duty, misstatements, or misleading statements, committed or omitted in the performance of the insured's professional services.

Directors & Officers Liability Insurance. D&O insurance typically provides three different benefits. First, D&O insurance generally provides direct coverage to past, present and future directors and officers of a company for unindemnified loss that the director(s) or officer(s) become legally obligated to pay because of a claim for "wrongful acts," including acts, errors, omissions, breaches of duty, misstatements, or misleading statements, committed or omitted in their capacities as directors and officers of the company. Second, D&O insurance usually provides coverage to the company for amounts paid to indemnify insured directors and officers for loss that such individuals are legally obligated to pay because of a claim for "wrongful acts." Finally, some D&O policies also provide "entity" coverage for loss that the insured company becomes legally obligated to pay because of a "securities claim," *i.e.*, claims asserted against the company by shareholders or claims arising out of the purchase or sale of, or the offer to purchase or sell, the company's securities.

[2] "Advertising" offenses may carry the added requirement that the offense be committed in the course of the insured's advertising activities.

Fiduciary Liability Insurance. Fiduciary Liability Insurance customarily insures loss that an insured becomes legally obligated to pay because of a claim for a "fiduciary wrongful act," including a breach by an insured of duties, responsibilities or obligations imposed upon fiduciaries of an employee pension or welfare benefit plan under ERISA or acts, errors or omissions by an insured in the administration of such plan(s).

Employment Practices Liability Insurance. EPLI policies generally provide coverage for loss that an insured company or its employees become legally obligated to pay because of a claim for an "employment practices wrongful act," which may include specific employment-related conduct, such as the following:

- Wrongful dismissal, discharge or termination;
- Breach of an oral or written employment contract;
- Employment related misrepresentations;
- Wrongful failure to promote/deprivation of a career opportunity;
- Violations of employment discrimination laws;
- Sexual harassment;
- Wrongful discipline/employee evaluation;
- Employment related invasion of privacy;
- Employment related defamation (libel and slander); and/or
- Employment related retaliation.

B. Which Polic(ies) Apply To A Given Liability Claim?

Apart from the substantive grants and limitations on "what" an insurance policy covers, liability insurance policies also contain temporal triggers indicating "when" coverage applies. For example, CGL policies typically require that covered "property damage" and "bodily injury" be caused by an "occurrence" or "accident" that takes place during the policy period. CGL policies are, thus, often referred to as "occurrence" policies because it is the timing of the "occurrence" that determines whether or which policies will respond to a claim. Under Texas law, an "occurrence" is deemed to take place when the actual property damage or bodily injury takes place. *See Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008). Likewise, coverage for "personal and advertising injury" is generally predicated on an "offense," *i.e.*, one of the acts described above, taking place during the policy period. *Trammell Crow Residential Co. v. Virginia Surety Co., Inc.*, 2008 WL 5062132, at *5 (N.D. Tex. Dec. 1, 2008) ("The Policy covers a 'personal injury' that 'arises out of an offense committed during the policy period.' It is the offense that must be committed during the policy period, not the personal injury."). As a result, an insured client may be able to obtain coverage under a CGL policy issued many years in the past regardless of when claims for liability are asserted against the insured.

By comparison, professional liability, E&O, D&O, fiduciary liability and frequently EPLI policies are triggered on a "claims-made" or "claims made and reported" basis, as opposed to an "occurrence" basis. Here coverage is triggered, not by damage, injury or conduct occurring during the policy period, but rather by claims made or claims made and reported within the policy period. A covered claim or suit asserted against the insured during the period of a "claims made" policy will trigger the policy's coverage, in many cases, regardless of when the underlying conduct or injury occurred.[3] Similarly, a "claims made and reported" policy will respond to claims/suits that are both made against the insured and reported to the insurer during the policy period.[4]

C. How To Make The Most Of Your Liability Insurance Coverage.

Every claim and every policy is in some respect unique. Successful prosecution of a given liability claim may turn on the specific nuances in contractual terms or other circumstances, but as a general rule, here are four fundamental issues with which corporate risk managers and in-house counsel should be familiar to ensure the best recovery for traditional third-party liability claims.

1. Giving Prompt Notice.

All insureds must provide notice in the manner specified in the policy, whether in writing or otherwise, by the proper parties to the proper party or agent of the insurer. *See, e.g.*, *Huddleston v. Traders & General Ins. Co.*, 465 S.W.2d 418, 420–21 (Tex. Civ. App.—Texarkana 1971, writ ref'd n.r.e.) (holding that an insured's oral notice of an "accident" did not satisfy the policy's requirement of written notice, notwithstanding the insured's immediate notification of a subsequent suit); *Executive Risk Indem., Inc. v. First State Bank, N.A.*, 2006 WL 42359, at *2 (N.D. Tex. Jan. 9, 2006) (holding that the insured's initial notice, directed to the insured's "insurance agent," was ineffective as the receiving party was the agent of the insured, not the insurer). As a first step, the insured or its counsel must determine which policies are likely to apply based on the type of claim or suit and when either the "occurrence" or "claim"/"suit" was made. Once the policies likely to respond have been identified, notice must be given without delay. As a practical matter, the insured's broker may be able to identify the appropriate policies and assist in giving notice of claims. When in doubt, notice should be given under all potentially applicable policies in order to ensure that coverage is preserved.

Under a general liability policy, a policyholder must not only provide notice of "claims" and "suits" but also of an "occurrence," *i.e.*, the accident or event giving rise to a later claim or suit against the insured, and of "demands, notices, summonses or legal papers received in connection with the claim or 'suit'". *See, e.g.*, ISO Form CG 00 01 04 13.[5] Notice of an "occurrence," claim or "suit" generally must be provided "as soon as practicable." There is no precise threshold after which notice will be deemed to be untimely. What constitutes "as soon as practicable" is ultimately a question of fact that depends on the circumstances of the particular claim. *Cont'l Sav. Ass'n v. U.S. Fidelity and Guar. Co.*, 762 F.2d 1239, 1243 (5th Cir. 1985) ("Under Texas law, similar phrases, such as "as soon as practicable" or "immediately," require only that notice be given within a reasonable time in light of the circumstances involved. While generally a question of fact, reasonableness becomes a question of law if the facts are undisputed." (citations omitted)).

Under an "occurrence" policy, including a CGL policy, if the insured fails to give "notice" as required, coverage may not be denied unless the insurer can demonstrate a material breach of the policy causing

[3] Some "claims-made" policies do exclude coverage for claims made during the policy period, which arise out of conduct or circumstances occurring prior to a defined "retroactive date" set forth in the policy.

[4] In most cases, "claims made and reported" policies provide a window after the close of the policy period for insureds to report claims made within the policy period.

[5] The terms quoted here generally apply to primary general liability coverage. By comparison, contractual terms governing notice under an excess liability policy may vary.

"prejudice" to the insurer. *See, e.g., PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630, 636–37 (Tex. 2008) ("We hold that an insured's failure to timely notify its insurer of a claim or suit does not defeat coverage if the insurer was not prejudiced by the delay."). As a general rule, "an insurer must demonstrate a material change in position to establish prejudice." *Coastal Refining & Marketing, Inc. v. U.S. Fid. & Guar. Co.*, 218 S.W.3d 279, 288 (Houston [14th Dist.] 2007, pet. denied). More particularly, an insurer must demonstrate "the precise manner in which its interests have suffered, meaning that an insurer must show . . . that there was a substantial likelihood of avoiding or minimizing the covered loss." *Trumble Steel Erectors, Inc. v. Moss*, 304 Fed. Appx. 236, 240–41 (5th Cir. 2008). In determining whether "prejudice" exists, Texas Courts have highlighted a number of facts, which alone or in combination with one another could potentially indicate a material breach relieving the insurer of its obligations to provide coverage to the insured for the improperly noticed claim.[6]

In contrast, under a "claims-made" policy, the failure to provide notice prior to the end of the subject policy period or follow-on reporting/discovery period can jeopardize the insured's coverage. *See, e.g., Ulico Cas. Co. v. Allied Pilots Ass'n*, 262 S.W.3d 773, 788–89 (Tex. 2008) (holding that an insurer was justified in denying coverage for a claim reported after the close of the policy period and for which no extended reporting period was granted by the insurer); *Matthews v. Home Ins. Co.*, 916 S.W.2d 666, 669 (Tex. App.—Houston [1st Dist.] 1996, writ denied) (holding that an insurer did not breach its contract in denying coverage for a claim reported under a claims-made policy after the close of the policy period); *see also Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Willis*, 296 F.3d 336, 339 (5th Cir. 2002) ("To invoke coverage under a claims-made policy, a claim must be made against the insured during the coverage period of the policy and the insured must notify the insurer of the claim during the same period.").

Some "claims-made" policies, such as directors' and officers' liability, errors and omissions liability and employment practices liability policies define those "claims" for which notice is required broadly to include not only "suits" but all "written demand[s] for monetary, non-monetary or injunctive relief." AIG Form 75011 (2/00). While the broad definition of "claim" generally favors the insured, the obligation to provide "notice" is correspondingly broadened as well. With this broad duty, policyholders must be careful to provide notice of "claims" that may not intuitively merit reporting to the insurer. *See, e.g., Munsch Hardt Kopf & Harr P.C. v. Executive Risk Specialty Ins. Co.*, 2007 WL 708851 (N.D. Tex. Mar. 8, 2007) (holding that an insured's failure to report an EEOC charge precluded coverage for a subsequent suit under a policy defining claims subject to notice as including "any judicial, administrative or other proceeding against any Insured for any Employment Practices Wrongful Act").

Nevertheless, insurers issuing "claims-made" policies must also demonstrate prejudice to justify the denial of a claim for which notice was not timely but nonetheless reported within the policy's period, subject generally to the principles set forth above. *See, e.g., Fin. Indus. Corp. v. XL Specialty Ins. Co.*, 285 S.W.3d 877, 879 (Tex. 2009) ("FIC gave notice of the claim within the policy's scope of coverage, *i.e.*, before XL could 'close its books' on the policy. Because XL was not denied the benefit of the claims-made nature of its policy, it could not deny coverage based on FIC's immaterial breach of the policy's prompt-notice provision."); *Prodigy Communications Corp. v. Agricultural Excess & Surplus Insurance Co.*,

[6] *See, e.g., Travelers Indem. Co. of Connecticut v. Presbyterian Healthcare Resources*, 2004 WL 389090, at *9 (N.D. Tex. Feb. 25, 2004) ("In determining whether an insurer has shown prejudice, courts consider factors such as: (1) the extent to which the nonbreaching party will be deprived of the benefit that it could have reasonably anticipated from full performance, (2) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived, (3) the likelihood that the party failing to perform will suffer forfeiture, (4) the likelihood that the non-performing party will cure his failure, and (5) the extent to which the behavior of the party failing to perform comports with standards of good faith and fair dealing."); *Nutmeg Ins. Co. v. Employers Ins. Co. of Wausau*, 2006 WL 453235, at *15 (N.D. Tex. Feb. 24, 2006) (holding that "prejudice" may be established when "(1) the insurer, without notice or actual knowledge of the suit, received notice after the entry of a default judgment against the insured; (2) the insurer received notice of the suit, but the trial date was fast approaching, thereby depriving it of an opportunity to investigate the claims or mount an adequate defense; (3) the insurer received notice of a lawsuit after the case had proceeded to trial and judgment has been entered against the insured; and (4) the insurer received notice of a default judgment against its insured after the judgment had become final and could not be appealed.").

288 S.W.3d 374, 382–83 (Tex. 2009) ("In a claims-made policy, when an insured notifies its insurer of a claim within the policy term or other reporting period that the policy specifies, the insured's failure to provide notice 'as soon as practicable' will not defeat coverage in the absence of prejudice to the insurer.").

2. Selection Of Counsel: Who Makes The Choice?

"When an insurer is faced with the dilemma of whether to defend or refuse to defend a proffered claim, it has four options: (1) completely decline to assume the insured's defense; (2) seek a declaratory judgment as to its obligations and rights; (3) defend under a reservation of rights or a non-waiver agreement; and (4) assume the insured's unqualified defense." *Katerndahl v. State Farm Fire & Cas. Co.*, 961 S.W.2d 518, 521. (Tex. App.—San Antonio 1997, no writ).

When a liability policy provides for a "duty to defend," many insurers will agree to defend under a reservation of rights, meaning that the insurer will accept its obligation to pay defense costs subject to various coverage defenses that may limit or preclude a duty to pay a future judgment or settlement in connection with the claim or suit once "facts" determining the insurer's duty to indemnify have been developed. *Northern County Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685, 689 (Tex. 2004) (stating that "[i]n the typical coverage dispute, an insurer will issue a reservation of rights letter . . . ."). If the facts that will determine the application of the coverage defenses asserted by the insurer are the same facts that will determine the outcome of the liability lawsuit, Texas law presumes a conflict of interest exists, which precludes the insurer from conducting the insured's defense as it might otherwise be entitled to do in the absence of a reservation of rights. *See, e.g.*, *Downhole Navigator, LLC v. Nautilus Ins. Co.*, 686 F.3d 325, 330 (5th Cir. 2012) ("The facts to be adjudicated may be the same facts upon which coverage depends in other situations, such as where the insurer reserves the right to deny coverage based upon a breach of contract exclusion and the underlying litigation raises a claim for breach of contract."); *Unauthorized Practice of Law Comm. v. Am. Home Assurance Co., Inc.*, 261 S.W.3d 24, 27 (Tex. 2008) ("Liability insurance policies that obligate the insurer to defend claims against the insured typically give the insurer 'complete and exclusive control' of that defense." (citing *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 627 (Tex.1998) ("The insurer's control of the insured's defense under this policy thus includes authority to accept or reject settlement offers and, where no conflict of interest exists, to make other decisions that would normally be vested in the client, here the insured."))); *see also Davalos*, 140 S.W.3d at 688 ("The right to conduct the defense includes the authority to select the attorney who will defend the claim and to make other decisions that would normally be vested in the insured as the named party in the case."). Under these circumstances—when the insurer has reserved rights on grounds overlapping with the defense of the underlying liability suit, the insured is entitled to select its own independent counsel, and the insurer remains liable for the reasonable defense costs incurred in connection with the suit. *See, e.g.*, *Hous. Auth. of the City of Dallas v. Northland Ins. Co.*, 333 F. Supp. 2d 595, 600–02 (N.D. Tex. 2004) (holding that "[w]hen a reservation of rights is made, the insured may . . . pursue his own defense[,] [and] [t]he insurer remains liable for attorneys' fees incurred by the insured" and concluding that "Northland is responsible for the attorney's fees reasonably incurred by DHA in its defense of the Bell lawsuit" (quoting *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 120 (5th Cir. 1983))); Todd R. Smyth, *Annotation, Duty of Insurer to Pay for Independent Counsel When Conflict of Interest Exists Between Insured and Insurer*, 50 A.L.R.4th 932, 938 (1986) ("Most courts appear to allow the insured to select independent counsel when a conflict of interests arises.").

Accordingly, even if an insurer with a "duty to defend" retains defense counsel to defend a suit, the insured may be entitled to appoint a different attorney of its choosing and demand payment for reasonable and necessary attorneys' fees incurred to defend the matter if one or more of the bases upon which the insurer has reserved the right to refuse payment for a settlement or judgment depend on facts, which will be litigated in the suit against the insured. If an insurer defending under a reservation of rights refuses to pay reasonable and necessary defense costs incurred by the insured's independent counsel, that insurer may be liable for interest on the amount of the outstanding defense costs at the rate of eighteen percent (18%) per annum. *See* TEX. INS. CODE § 542.060.

When a policy does not provide for a "duty to defend," but rather offers only the advancement or reimbursement of "defense costs," the insured is generally entitled to select its own counsel (albeit oftentimes from a panel of firms pre-selected the insurer) and to control the defense of a claim, subject to the reasonable consent of the insurer.[7]

3. Getting Paid For Defense Costs.

Whether the insured has exercised its right to select counsel in response to a "reservation of rights" letter or is seeking advancement of defense costs from an insurer without a "duty to defend," insureds and defense counsel will likely encounter various attempts by insurers to assert indirect control over the cost the insured's defense through the use of "billing" or "litigation management" guidelines or other means. These so-called "guidelines" purport to limit payment to rates charged by the insurer's captive counsel or to restrict or eliminate payment for inter-office conferences, duplicate attendance at depositions or hearings, computerized legal research, and even such expenses as telecopier charges, secretarial overtime, long-distance telephone charges, and courier fees.

With respect to the rates charged by "defense counsel," the textual requirement of many liability policies is that the defense costs be "reasonable"—not that they conform to some arbitrary rate charged by the insured's captive counsel or to the insured's internal billing guidelines. *See, e.g.*, *Kirby v. Hartford Cas. Ins. Co.*, 2003 WL 23676809, at * 2 (N.D. Tex. 2003) (arguing that "Hartford cites no authority for its conclusion that Kirby is obligated to accept defense counsel 'appointed' by Hartford or be limited to any rate the insurer is able to negotiate with such counsel."); *Kirby v. Hartford Cas. Ins. Co.*, 2004 WL 2165367 (N.D. Tex. 2004) (awarding Kirby its actual defense costs as damages). Unless made a part of the insurance policy itself, billing guidelines do not alter the rights and obligations of the parties to the liability insurance contract under which the "duty to defend" or to pay "defense costs" is owed. *Cf. Ulico Cas. Co. v. Allied Pilots Ass'n*, 187 S.W.3d 91, 104 (Tex. App.—Fort Worth 2005, pet. granted), *rev'd on other grounds*, 2008 Tex. LEXIS 769 (Tex. Aug. 29, 2008) ("[N]othing in the Association's policy indicates that defense costs must be in compliance with the litigation management guidelines promulgated by Ulico . . . .")

Moreover, defense counsel, as well as insurers, should be aware of the risks created when a non-defending insurer becomes unduly intertwined in decisions driving the insured's defense—particularly when there are unresolved coverage issues between the insurer and its insureds. For example, ethical standards in many states prohibit controls placed on defense counsel that could compromise counsel's judgment in defending the insured. *See, e.g.*, State Bar of Texas Ethics' Opinion No. 533 ("[I]t is impermissible under the Texas Disciplinary Rules of Professional Conduct for a lawyer to agree with an insurance company to restrictions which interfere with the lawyer's exercise of his or her independent professional judgment in rendering such legal services to the insured/client."). Likewise, whether pursuant to an audit or otherwise, disclosure of attorney work product or privileged communications to an insurer, whose coverage positions suggest an adversarial relationship with the insured, creates an unnecessary risk of waiver.[8]

Alternatively, D&O liability insurers, in particular, may attempt to limit payment for "defense costs" by arguing that a single suit involves both covered and uncovered matters or covered and uncovered parties, thereby justifying an allocation of covered and uncovered "defense costs." However, "[n]o right of allocation exists for the defense of non-covered claims that are 'reasonably related' to the defense of covered claims." *See, e.g., Nordstrom, Inc. v. Chubb & Son, Inc.*, 820 F. Supp. 530, 535 (W.D. Wash. 1992), *aff'd*, 54 F.3d 1424 (9th Cir. 1995) (citing *Fed. Realty Inv. Trust v. Pacific Ins. Co.*, 760 F. Supp. 533, 536–37 (D. Md. 1991) (holding that an insurance company is not entitled to allocation of defense costs when legal services benefitted the defense of both covered and non-covered claims)); *see also Raychem Corp. v. Fed. Ins. Co.*, 853 F. Supp. 1170, 1182 (N.D. Cal. 1994) ("In evaluating whether

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[7] *See, e.g., Executive Risk Indem., Inc. v. Jones*, 89 Cal. Rptr. 3d 747, 751 n.4 (Cal. Ct. App. 2009) ("D&O Policies are indemnity-only policies, whereby the insurer reimburses defense expenditures only after the insured selects counsel, controls the defense, and submits the defense bill.").

[8] *See, e.g., Bovis Lend Lease, LMB, Inc. v. Seasons Contracting Group*, 2002 WL 31729693, at *8 (S.D.N.Y. Dec. 5, 2002) (compelling production of correspondence between insurer and insured because (1) "[m]erely because a communication is between an insurer and insured does not render it privileged;" and (2) at the time this letter was written, the insurer was not defending the insured); *In re Imperial Corp. of Am.*, 167 F.R.D. 447 (S.D. Cal. 1995) (correspondence from insured to adverse insurance carrier was not privileged, and work product immunity was waived with respect to opinions and analysis contained therein).

defense costs should be allocated between the corporation and the insured directors and officers, courts have adopted the 'reasonably related' test."). As long as there is a covered claim, insurers should not deny payment for "reasonably related" defense costs—whether incurred in connection with nominally different parties, different claims or different proceedings. *Cont'l Cas. Co. v. Bd. of Educ.*, 489 A.2d 536 (Md. Ct. App. 1985) ("So long as an item of service or expense is reasonably related to the defense of a covered claim, it may be apportioned wholly to the covered claim."); *cf. Applied Tech Prods. v. Select Ins. Co.*, 2004 U.S. Dist. LEXIS 8449, at *11 (E.D. Pa. Apr. 29, 2004) ("[W]hen defense costs cannot be apportioned, the insurer ordinarily must assume the cost of the defense for both covered and non-covered claims.").

In short, policyholders with a right to control their own defense—whether on the basis of the insurer's reservation of rights or by virtue of express policy terms—should be wary of attempts by insurers to exert control through litigation "guidelines," allocation schemes and arbitrary rate limitations, that effectively deny the insured the full defense to which it might otherwise be entitled under a policy or at law.

4. Settling & Paying Third-Party Claims.

In addition to controlling the defense, some liability policies grant the insurer the express right to control settlement of claims and suits. *See* www.irmi-online.com (citing Scottsdale Insurance Company, Public Officials Liability Coverage Form, PES-PO-2 (8–02) ("We have the right to settle any "claim" or "suit" as we deem expedient without any insured's consent."). Other policies implicitly confer control of settlement upon the insurer by stating that the insured must not "voluntarily make a payment, assume any obligation, or incur any expense, . . . without our [the insurer's] consent." *See, e.g.*, ISO Form CG 00 01 04 13.

In recognition of the control exercised by the insurer over the settlement process and the risks to the insured (which may eclipse the limits of the insurance contract) should the insurer fail to act appropriately, the common law in Texas has created the *Stowers* duty, or generally, the duty to act reasonably in the settlement process.[9] Under Texas law, the insurer's exercise of control over the settlement of an insured's claims makes the insurer an agent of the insured and responsible to act with "*that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business*." *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved). The breach of this duty to act reasonably may expose the insurer to liability in excess of its contractually agreed policy limit if "(1) the claim against the insured is within the scope of coverage; (2) the demand is within the policy limits; and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment." *Am. Physicians Insurance Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994). An effective *Stowers* demand must also contain an unconditional offer to release an insured from all liability. *See Trinity Universal Ins. Co. v. Bleeker*, 966 S.W.2d 489, 491 (Tex. 1998).

Lawyers who understand the *Stowers* doctrine are able to exert pressure on insurance carriers to fund settlements, even when the underlying claim to be settled may be subject to unresolved coverage issues. Indeed, an insurer faced with a proper *Stowers* demand may prefer to pay a potentially uncovered claim rather than risk possible liability in excess of policy limits. *See, e.g.*, *Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 46 (Tex. 2008) ("[A]n insurer that rejects a reasonable offer within policy limits risks significant potential liability for bad-faith insurance practices if it does not ultimately prevail in its coverage contest."). When an insurer settles a third-party claim, absent an express agreement to the contrary, the insurer is not entitled to seek reimbursement for the so-called "uncovered" portion of the insured's liability, if any. *Id.* at 43 (acknowledging that "an insurer that settles a claim against its insured when coverage is disputed may seek reimbursement from the insured should coverage later be determined not to exist" but only "if the insurer 'obtains the insured's clear and unequivocal consent to the settlement and the insurer's right to seek reimbursement.'").

When an insurer has wrongfully refused to defend or has otherwise breached its contract with the

[9] *Foremost County Mut. Ins. Co. v. Home Indem. Co.*, 897 F.2d 754, 758 n.5 (5th Cir. 1990) ("[T]he raison d'etre for the *Stowers* doctrine is that the insurer, when in control of the litigation, might refuse a settlement offer that its client, the insured would want to accept if it had the option.").

insured, the policyholder is not bound by the "voluntary payments" clause (or any other policy condition), but may settle or litigate the claim according to its preference. *Rhodes v. Chicago Insurance Co.*, 719 F.2d 116, 120 (5th Cir. 1983) ("An additional consequence of a breach of the duty to defend is the inability to enforce against the insured any conditions in the policy."); *Gulf Ins. Co. v. Parker Prods., Inc.*, 498 S.W.2d 676, 679 (Tex. 1973) ("The insurance company may ordinarily insist upon compliance with this condition for its own protection, but it may not do so after it is given the opportunity to defend the suit or to agree to the settlement and refuses to do either on the erroneous ground that it has no responsibility under the policy."). Moreover, an insurer, who sustains no prejudice from a settlement without its consent, cannot justify a denial of coverage on its lack of consent alone. *Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691, 693 (Tex. 1994) ("[A]n insurer who is not prejudiced by an insured's settlement may not deny coverage under a[] . . . policy that contains a settlement without consent clause."). Risk managers and in-house counsel, who understand these concepts, can make critical decisions regarding the settlement of third-party claims, without compromising available insurance coverage.

III. Maximizing The Value Of First-Party Claims Under Commercial Property Insurance.

A. What Is Commercial Property Insurance?

Commercial property insurance generally comes in two varieties—"all risk" and "named peril" insurance. "All risk" policies will cover the insured against "all risks" of "direct physical loss or damage" to covered property occurring during the policy period. "Named peril" coverage also insures against "direct physical loss or damage" to insured property, but only if caused by specific enumerated hazards, such as fire, theft and hail.

In addition to providing general coverage for direct physical loss or damage to specific property from particular covered causes of loss, commercial property policies may contain "Additional Coverages" expanding the types of loss for which a policyholder may seek coverage under a given policy. For example, many commercial property policies provide "additional" coverage for the reasonable and necessary costs incurred to temporarily protect and preserve insured property to the extent necessary to prevent actual or immediately impending physical loss or damage to which the insurance would otherwise apply. Other common "Additional Coverages" found in some policies include: Debris Removal; Pollution Clean-up and Removal; and Demolition and Increased Cost of Construction. All coverages are generally subject to exclusions, conditions, definitions and other endorsed terms.

Commercial property policies also typically include some form of "business interruption" coverage. Where a commercial property policy insures against the risk that the assets of a business may be damaged or destroyed, generally speaking, business interruption insurance compensates the policyholder for the loss of income, including continuing ordinary business expenses, for a specified period of time after the insured's business is impaired as a result of direct physical loss or damage to the insured's own business premises from covered cause(s) of loss.

Just as there are many sources of income and various means of calculating earnings, commercial property policies provide a number of distinct business interruption coverages. One common coverage insures "gross earnings," which obligates the carrier to pay for the actual loss of the insured's gross income during the period that the insured's business has been interrupted, reduced by the amount of any expenses that do not continue during the same period. Therefore, although standard gross earnings coverage may provide reimbursement for property taxes and other continuing expense items, a standard commercial property policy will usually not cover those marginal operating expenses which cease at the same time the insured's business is suspended, including hourly payroll. Relatedly, it is not uncommon for carriers to provide an endorsement limiting the number of days for which the carrier will cover continuing payroll expense.

In addition to gross earnings coverage, commercial property policies may also contain one or more of the following business interruption coverages:

Contingent Business Income. As local economies becomes more interconnected with others around the country and across the globe, catastrophic loss in one region or country may have devastating impact on business in otherwise remote or distant parts of the world. Destruction of a manufacturing facility in Shanghai may result in a shortage of inventory in Spokane. As a result, sophisticated insureds are increasingly purchasing contingent or dependent business income coverage which generally provides coverage for actual loss sustained or extra expense incurred due to impairment of an insured's business operations, provided that such impairment or suspension is caused by direct physical loss or damage from a covered peril to dependent business premises, including those customers or suppliers upon which the insured's business relies.

Extended Business Income. An insurer's liability for business income loss typically terminates when the insured's premises or other property is or could be restored with reasonable speed and similar quality. However, even after the policyholder's property is repaired or replaced, it may be some time before the insured's business operations return to pre-loss conditions. Therefore, many insureds will opt to obtain "extended" business income coverage. Such provisions usually provide that the insured may recover business income loss, otherwise covered, for a specified period of time after the insured's property is repaired or replaced, to allow time for the insured's business to resume.

Extra Expense. Although business interruption loss is compensable under many commercial property policies, most carriers only insure such loss to the extent that it cannot be reduced by using other facilities or personnel at the insured's disposal. In other words, if, for example, a company's manufacturing operations at one site were terminated by catastrophic loss, a carrier would likely not cover lost income from that facility, if production could be transferred to a different non-damaged facility. However, to the extent that in doing so, the company would incur overtime or other extraordinary expense, the "extra expense" coverage may provide coverage for such expenses. In short, many policies provide coverage for the reasonable and necessary costs incurred to temporarily continue the insured's business during a specific period.

Civil Authority. Often business interruption is caused by direct physical loss or damage to the insured's premises. However, in the event of a significant catastrophe, including hurricanes and tornadoes, an insured's business operations may be suspended as a result of restrictions placed by police, or other civil authorities. For this risk, commercial property policies will sometimes provide coverage for the loss of income sustained or extra expense incurred by an insured whose business operations are suspended because of actions by civil authorities to prohibit access to specified premises due to direct physical loss or damage to other property caused by a covered cause of loss. In contrast to other business interruption coverages, civil authority coverage typically begins within a number of hours after the restrictions are in place and continues for a discrete number of days or weeks.

Ingress/Egress. Like civil authority coverage, ingress/egress provisions typically provide coverage for business income loss sustained and extra expense incurred when, as a result of a covered peril, ingress, access to, or egress from an insured property is prevented or impaired. These provisions generally do not require that the peril damage the insured property or, for that matter, that any property be damaged at all, and no civil authority order preventing access is required by such provisions. Like civil authority provisions, however, reimbursement for ingress/egress loss will usually continue for a specified number of days or weeks.

Service Interruption. An insured's business operations may be suspended not only because of actual physical loss or damage to the insured's premises, but also may be caused by a lack of incoming electricity, gas, fuel, water, data/communication or other services as well as from the lack of outgoing communication, sewer or other services. Some commercial property policies provide coverage for income lost and extra expense incurred when the providers of these services suffer direct physical loss or damage from a covered peril. Provisions providing service interruption coverage usually require the insured to notify the service provider and may be subject to other conditions and/or restrictions. Likewise, some carriers impose a waiting period before coverage will apply and may otherwise limit the period(s) during which this coverage is offered.

Specialized Income. Some commercial property policies will provide coverage for particular types of income, including rental insurance or insurance covering commissions or royalties.

In addition to limiting the dollar amount payable for various business interruption coverages, insurers will also limit the period of time during which loss of income or extra expense will be measured and compensated. Typically, for gross earnings and coverages triggered by physical loss or damage to the insured's property, the period during which the insurer will reimburse covered losses begins within a number of hours or days after the physical loss or damage is sustained and often ends either when the property at the specified premises should be repaired or replaced with reasonable speed and similar quality or when business is resumed at a new permanent location, whichever is earlier. For other coverages like civil authority, ingress/egress, and service interruption, insurers may provide a discrete period of days or weeks during which coverage applies.

To the extent that there is a dispute between the policyholder and the carrier regarding the amount of compensable loss, many commercial property policies will contain appraisal provisions permitting either party to make a written demand for appraisal whereby each party selects a competent and impartial appraiser. The appraisers, then, will select an umpire to which the parties will submit their differences, and a decision from the umpire agreed to by any two will be binding.

B. How To Increase Recovery For Traditional Commercial Property Claims.

Commercial property and business interruption claims can be enormously complex. Coverage for vast sums of property damage or lost revenues may turn on seemingly innocuous policy terms or nuances in calculation. While there are no guarantees in any insurance claim or in litigation, here are some key concepts and best practices that provide the greatest chance for enhanced recovery under a traditional commercial property policy.

1. Giving Notice & Documenting Your Loss.

In addition to giving notice of a loss, it is generally up to the insured to document any claimed damage in filing a written "proof of loss" with the insurer. Risk managers and in-house counsel should be aware of the applicable deadlines within the policy, as filing of the "proof of loss" will trigger the insurer's obligation to pay under the policy. If additional time is needed, the insured should ask for and document an extension.

The process by which an insured submits and recovers for a property damage or business interruption claim is by nature an adversarial process. *See, e.g.*, *Lexington Ins. Co. v. Island Recreation Dev. Corp.*, 706 S.W.2d 754, 756 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.) (involving a dispute over coverage for fixed expenses). The insurer, experienced in handling such claims, will treat the claims process as such. It is important to involve attorneys and other professionals skilled in handling first party claims to protect the insured's interests and ensure a complete recovery. In some cases, and particularly those involving business interruption claims, it may be appropriate to retain a forensic accountant or other professionals to assist in preparing necessary documentation to support the claim.

The cost associated with professional services performed to prepare a "proof of loss" may also be compensable under the commercial property policy. Corporate policyholders should also be aware of (1) any contractual limitations provisions, requiring the insured to bring litigation against an insurer within a specified period of time, as well as (2) applicable statutes limiting the enforceability of such contractual limitations provisions. *See, e.g.*, TEX. CIV. PRAC. & REM. CODE § 16.070 ("[A] person may not enter a stipulation, contract, or agreement that purports to limit the time in which to bring suit on the stipulation, contract, or agreement to a period shorter than two years.").

2. Satisfying Other Policy Conditions.

In addition to giving notice and submitting a timely proof of loss, many commercial property policies require insureds to take other actions. Depending on the terms of a given policy, the insured must:

- Notify police if a law may have been broken;
- Take all reasonable steps to protect the covered property from further damage, regardless of the cause of loss;
- Keep a record of all expenses necessarily incurred to protect the covered property;[10]
- If possible, set aside the damaged property in the best possible order for examination by the carrier;
- Permit the insurer, as often as may be reasonably required, to inspect the property

[10] Under many policies, these expenses even if incurred to protect the property from a non-covered cause of loss will be considered by the insurer in settlement of the claim and may be compensated. However, where possible, the best practice is to consult with the loss adjuster before taking steps to protect property in order to ensure that those expenses incurred will be reimbursed by the carrier.

proving the loss or damage, including providing the insurer with access to relevant books and records for examination;

- Permit the insurer to take samples of the damaged and undamaged property for inspection, testing and analysis, including permission for the insurer to make copies from relevant books and records;
- Resume all or part of any business activities previously occurring at the specified premises as soon as possible if it is the insured's intention to continue the business; and
- Cooperate with the insurer in the investigation and/or settlement of the claim.

Failure to satisfy one or more of these conditions may jeopardize the insured's coverage for business interruption as well as property damage. *But see Lambrecht & Assoc., Inc. v. State Farm Lloyds*, 119 S.W.3d 16, 26 (Tex. App.—Tyler 2003, no pet.) (finding that notification of police in the event that a law has been broken is not a condition precedent to coverage for business interruption loss).

3. Valuing Covered Loss & Damage.

Coverage for even non-excluded loss and damage may be limited by the "valuation" provisions in a commercial property policy. Most commercial property policies will compensate for damaged structures on a "replacement cost" basis—the cost to rebuild or replace the structure at the same location with new materials of like kind, size and quality—provided that the repair or replacement occurs within a specified period of time. If the damage is not replaced within the specified period of time, coverage may be limited to "actual cash value"—which is the "replacement cost" less applicable depreciation. In order to realize the full benefit of a commercial property policy, insureds should comply with the deadlines required to receive full replacement value and avoid any deduction for depreciation. In some cases, this may be possible by applying the proceeds of a commercial property policy to a qualifying capital project in another location. Risk managers and in-house counsel should request advances from the insurer against the anticipated value of a claim for property damage or business interruption to enable the timely repair or replacement of covered property.

In addition to limiting coverage by exclusions, insurers may impose deductibles or coinsurance clauses as a means of reducing or controlling exposure to loss or damage. Standard coinsurance provisions require the insured to purchase limits equal to some percentage of the insured property value or anticipated net income and continuing expense for a specified period, or else bear a portion of any future loss uninsured. If at the time of the loss, the limits purchased are less than the specified percentage or amount, the insurer will only pay that proportion of the amount of loss or damage claimed represented by the ratio between the limit of insurance purchased and the required value of the property damage or business income loss to be insured. Where possible, policyholders should avoid such clauses and the disputes over valuation that may attend these provisions in the event of a claim.

Subject to the terms of the specific policy, commercial property insurance generally covers "physical loss and damage" to insured property. In some cases, property that is not "damaged" may nonetheless be "physically lost" for purposes of coverage. For example, when a partial collapse of a roof or the infiltration of gas vapors or other contaminants renders an otherwise un-"damaged" property unsafe or unusable, such conditions may qualify as "physical loss" under a commercial property policy. In pursuing coverage for commercial property claims, policyholders should seek coverage for not only what is "damaged" but also what is physically "lost." *See, e.g., Matzner v. Seaco Ins. Co.*, 1998 Mass. Super. LEXIS 407, at * 9–12 (Mass. Super. Aug. 26 1998) (interpreting "direct physical loss" broadly in favor of coverage to include carbon monoxide contamination which rendered the building unusable but did not affect its structural integrity); *Customized Dist. Servs. v. Zurich Ins. Co.*, 862 A.2d 560, 565 (N.J. Super. Ct. 2004) (finding that mis-rotation of goods having no effect on the material composition of the goods but rendering them unfit for sale was "direct physical loss"); *Adams-Arapahoe Joint Sch. Dist. No. 28-J v. Cont'l Ins. Co.*, 891 F.2d 772 (10th Cir. 1989) (partial collapse of roof rendered all corroded portions of school roof unsafe).

4. "Efficient Proximate Cause" & "Concurrent Causation."

Many commercial property policies exclude coverage for loss or damage arising out of perils such as faulty workmanship, ordinary wear and tear, depreciation, deterioration, or damage resulting from mold, corrosion or wet/dry rot. Consequently, in the event of a significant property or business interruption claim, questions may arise as to whether, for example, damaged roofing was the result of a covered windstorm or excluded long term depreciation, or even both.

Over time, courts have developed legal doctrines to determine coverage when excluded and non-excluded causes contribute to a loss. Some jurisdictions follow a "concurrent causation" approach whereby damage, that may have resulted from multiple causes, is compensable if the insured can trace or allocate the damage to a covered peril. *See, e.g.*, *Allison v. Fire Ins. Exch.*, 98 S.W.3d 227, 258-59 (Tex. App.—Austin 2002, pet. granted, judgm't vacated w.r.m.) ("Under [the concurrent causation] doctrine, when covered and non-covered perils combine to create a loss, the insured is entitled to recover only that portion of the damage caused solely by the covered peril."). Other jurisdictions follow an "efficient proximate cause" theory whereby damage is insured if the non-excepted cause is the "prime" or "moving" cause of the loss, notwithstanding other more remote or intermediate, excluded causes of loss. *See, e.g., Mammina v. Homeland Ins. Co.*, 9 N.E.2d 437 (Ill. Ct. App. 1937) ("[I]t is well settled that when an efficient cause nearest the loss is a peril expressly insured against, the insurer is not relieved from responsibility by his showing that the property was brought within that peril by a cause not mentioned in the contract."); *Suttir v. Indem. Co. of Am.*, 1922 WL 2555, at *2 (Ill. Ct. App. 1922) ("In order to constitute . . . the proximate cause of the loss . . . , it is not necessary that the fire be should be the sole cause or the last or nearest cause. It is sufficient if it concurs with some other cause acting at the same time, which in combination with it, produces the loss, or if it sets in motion a chain of circumstances and operates on them in a continuous sequence, unbroken by a new or independent cause.").

Policyholders should be familiar with approach applicable to their own commercial property policy in preparing and pursuing claims. Risk managers and in-house counsel responsible for the placement of corporate insurance policies should also be aware of and avoid, if possible, "anti-concurrent causation" clauses whereby a loss is excluded if an excluded peril or event contributed concurrently or in any sequence to cause the loss.

5. Considering Appraisal.

Many commercial property policies contain "appraisal" clauses allowing the insurer or the insured to submit disputes over the amount of loss or damage to a panel of appraisers, often consisting of two party-appointed appraisers and a third "neutral" appraiser. Corporate policyholders should be familiar with and weigh carefully how the terms of an applicable "appraisal" clause—which are increasingly favored by courts—may impact the insured's pursuit of a commercial property claim. For example, insureds should be vigilant to ensure that the scope of any appraisal process is appropriately limited to the valuation issues authorized by the appraisal provision itself. Policyholders should also determine whether the appraisal clause permits the insurer, the insured or both to litigate coverage issues after appraisal has been conducted. Familiarity with these provisions may ensure that the insured's extra-contractual claims are preserved even after appraisal is complete or may even limit the insurer's right to deny coverage after initiating appraisal. *See, e.g., Angott v. Chubb Group of Ins. Cos.*, 717 N.W.2d 341, 347 (Mich. Ct. App. 2006) ("By demanding an appraisal and failing to seek court intervention to determine coverage issues before the appraisal, and considering defendant's concessions in the answer and affirmative defenses cited above, defendant became bound by the appraisal award absent bad faith, fraud, misconduct, or manifest mistake, and it waived a coverage-based challenge of the appraisal award." (relying on *Auto-Owners Ins Co v. Kwaiser,* 476 N.W.2d 467 (Mich. Ct. App. 1991))).