A Lamb in Wolf's Clothing: The Insurer's Duty to Defend Business Torts

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Like the Big Bad Wolf who hounded Little Red Riding Hood, a lawsuit filed against a business owner means big trouble, not only in terms of commanding the company's time and energy, but also in siphoning off from the operating budget significant finances to pay attorney fees and litigation expenses. But a bad situation is made even worse when the business owner fails to recognize the lamb that may be lurking beneath the surface of the biggest and baddest wolf.

Usually, the company's first reaction is to call corporate counsel and either circle the wagons or commence an offensive blitzkrieg in an attempt to diffuse the obviously meritless litigation.

The mantra of the accused wrongdoer is predictable. The charges are frivolous. They are designed to promote the competitor's own business agenda. They are intended to cloud the competitor's own unscrupulous practices. We will battle these unfounded allegations to the bitter end.

When the bitter end finally arrives the company has incurred hundreds of thousands of dollars in defense costs and litigated the matter to death for several years, but at least the matter is finally over. Or is it?

A few months later, while having an annual review with its risk consultant, the company's executives casually mention the litigation, and the agent poses a simple question—did anybody ever report this claim to the company's carrier?

Once again, the wagons are circled, only this time it is the corporate counsel and its malpractice carrier doing the circling.

The standard CGL policy provides personal injury coverage, which, despite its name, has nothing to do with personal injury claims such as automobile accidents or product liability suits. Instead, personal injury coverage provides indemnity—and, perhaps more importantly, a defense for—a wide array of business torts that practitioners may, at first blush, dismiss as uninsured claims.

A practitioner does so at great peril. Even without a specific request from the client-policyholder, counsel should always be on the lookout for claims that may trigger an insurance company's duty to defend and, thus, relieve the client of the often times significant defense cost associated with a business tort claim.

The Law on Duty to Defend

Liability insurers owe two separate duties to their insureds—the duty to defend and the duty to indemnify.

The duty to defend is quite broad, and is subject to the following rules:

1. The duty to defend is broader than the duty to indemnify.[1] As stated in Kalis, *Policyholder's Guide to Insurance Coverage*, § 4.02, p. 4-5 (2000):

> An insurer's duty to defend is broader than its duty to indemnify the insured. Accordingly, an insurer may be required to defend an action for which it ultimately is not required to indemnify the insured.

2. The duty to defend is determined by the scope of the allegations in the complaint.[2]

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[1] *Motorists Mut. Ins. Co. v. Trainor* (1973), 33 Ohio St.2d 41, 294 N.E.2d 874

[2] *Trainor*, *supra*

3. Where the insurer's duty to defend is not apparent from the pleadings in the action against the insured, but the allegations do state a claim which is potentially or arguably within the policy coverage, or there is some doubt as to whether a theory of recovery within the policy coverage has been pleaded, the insurer must accept the defense of the claim.[3]

4. An insurer has an "absolute duty to assume the defense of the action where the underlying tort complaint states a claim which is potentially or arguably within the policy coverage."[4] If the facts may be read to support a potentially covered claim, the insurer must defend, even if the underlying claim is incompetently or inartfully drafted, or fails to state the formal legal theory upon which the claim is based.[5]

5. When a complaint contains more than one claim based on the same occurrence, only one of which is within the coverage of the policy, the insurer must defend its insured against all claims.[6]

6. The insurer's duty to defend arises the moment suit is filed, and is not dependent on its ultimate liability to the insured for the verdict.[7]

7. Doubts in the pleadings regarding coverage, if any exist, must be resolved in favor of the insured rather than in a separate factual inquiry.[8]

8. The duty to defend is a legal issue that is decided by the court, not a factual issue for a jury to resolve.[9]

9. When a conflict of interest exists between an insurer and an insured by virtue of a reservation of rights letter or a complaint that asserts both covered and non-covered causes of action, the insurer **must** hire

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[3] *Willoughby Hills v. Cincinnati Ins. Co.* (1984), 9 Ohio St.3d 177, 459 N.E.2d 555

[4] *Sanderson v. Ohio Edison Co.* (1994), 69 Ohio St.3d 582, 635 N.E.2d 19

[5] Anderson, *Insurance Coverage Litigation*, § 3.02, p. 3-10 (2001)

[6] *Preferred Mut. Ins. Co. v. Thompson* (1986), 23 Ohio St.3d 78, 491 N.E.2d 688

[7] *Bloom-Rosenblum-Kline Co. v. Union Ind. Co.* (1929), 121 Ohio St. 220, 167 N.E. 884

[8] *Zanco, Inc. v. Michigan Mut. Ins. Co.* (1984), 11 Ohio St.3d 114, 464 N.E.2d 513, (noting that the duty to defend arises "if the pleading against the insured contains allegations which are vague, nebulous, or incomplete such that a potential for coverage exists.")

[9] *Leber v. Smith* (1994), 70 Ohio St.3d 548, 639 N.E.2d 1159; *Alexander v. Buckeye Pipe Line Co.* (1978), 53 Ohio St.2d 241, 374 N.E.2d 146

independent counsel to represent the insured or allow the insured to select private counsel that the insurer must pay.[10]

Personal Injury Coverage in the CGL Policy

The most common liability form used is the occurrence-based CGL policy issued by the Insurance Services Office. The 1998 form, CG 00 01 07 98, provides coverage for damages arising from personal and advertising injury, which is defined as:

> "Personal and advertising injury" means injury, including consequential "bodily injury", arising out of one or more of the following:
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> a. False arrest, detention or imprisonment;
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> b. Malicious prosecution;
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> c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;
>
> d. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organization's goods, products or services;
>
> e. Oral or written publication of material that violates a person's right of privacy;
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> f. The use of another's advertising ideas in your "advertisement"; or
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> g. Infringing upon another's copyright, trade dress or slogan in your "advertisement".

Personal injury coverage was introduced by ISO in 1976, and became a standard part of ISO's CGL policy in 1986. The nature of the coverage has not changed substantially in the last twenty-seven years. Business lawsuits need to be examined

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[10] *Socony-Vaccum Oil Co. v. Continental Casualty Company* (1945), 144 Ohio St. 382, 59 N.E.2d 199; Windt, *Insurance Claims and Practices*, § 4.20 (3rd Ed. 1995)

carefully to determine whether any of the claims fall within the personal injury coverage and, thus, whether the carrier is obligated to defend the entire case.

Unlike coverage for bodily injury and property damage, personal injury coverage does not depend on the existence of an "occurrence." Accordingly, there is no requirement that the claim be accidental; many intentional torts are covered, the most obvious being malicious prosecution.

Defamation and Product Disparagement Claims

Allegations of defamation or disparagement are the lynchpins of obtaining a defense from a carrier under the personal injury coverage. However, the allegations are usually buried in a voluminous complaint, the primary focus of which is often other traditionally non-covered causes of action such as breach of contract, antitrust violations, fraud, or misappropriation of trade secrets.

Slander and defamation are synonymous since slander is defined as an oral defamation. According to the Restatement of the Law 2d, Torts §558 (1977), defamation consists of:

(a) a false and defamatory statement concerning another;

(b) an unprivileged publication to a third party;

(c) fault amounting to at least negligence on the part of the publisher; and

(d) either actionability of the statement irrespective of special harm or the existence of special harm caused by the publication.

In *Amerisure Insurance Co. v. Laserage Technology Corp.*[11] a policyholder's competitor filed a complaint alleging breach of contract, fraud, misappropriation of trade secrets, antitrust violations, and a host of other causes of action. Among the myriad of

[11] 2 F. Supp.2d 296 (W.D.N.Y. 1998)

allegations was a claim that the policyholder made misrepresentations to mutual or potential customers that the competitor's products infringed patents. The court held that this was an allegation of defamation or disparagement, which—had the policyholder promptly given notice to the carrier—would have given rise to a duty to defend:

> It seems obvious to this Court that wrongfully asserting that a competitor's product infringes patents clearly defames the competitor and disparages his product.

However, the policyholder waited eight months to give notice to the carrier because the policyholder did not think the policy provided coverage. The court held that this delay was unreasonable, and granted the carrier summary judgment, leaving the policyholder holding the bag for $1.1 million in attorney's fees.

Numerous similar causes of action were involved in the underlying complaint in *Federal Insurance Co. v. Cablevision Systems Dev. Co.*[12]. Cablevision's competitor alleged, among other things, that Cablevision had "disparaged through false and misleading statements plaintiffs' character and reliability and the quality of plaintiffs' services." The court found that this allegation "asserts a claim potentially within the coverage" and was sufficient to trigger the carrier's duty to defend.

The analysis of the underlying complaint is fairly straightforward if it includes a cause of action labeled "Slander" or "Defamation". However, several cases have held that a duty to defend arises even if the underlying complaint is not so specific or is even legally deficient. In a lawsuit against the author of *Fatal Vision*, which recounted the murder trial of Jeffrey MacDonald, the convicted murderer asserted that the author did not accurately portray the full story of the murder investigation, that the author breached

[12] 637 F. Supp. 1568 (E.D.N.Y. 1986)

a covenant of fair dealing that he had entered into with MacDonald, and that the author had written material containing false statements that he knew would subject MacDonald to mental anguish and embarrassment.[13]

The court pointed out that in determining whether the author's liability carrier had a duty to defend MacDonald's lawsuit, it was necessary to "look past the labels placed on MacDonald's causes of action to the facts alleged in the complaint." The court held that MacDonald's lawsuit contained an inartfully drawn cause of action for libel, which was covered by the policy. Thus, the carrier owed a defense.

Other Potentially Covered Business Torts

Besides claims for slander, libel, and defamation, there are numerous business torts that may arguably give rise to a duty to defend including antitrust violations[14], discrimination claims[15], claims challenging unreasonable zoning decisions[16], trespass and nuisance claims[17], certain environmental claims[18], certain pollution claims[19], unfair

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[13] *McGinnis v. Employers Reinsurance Corp.*, 648 F. Supp. 1263 (S.D.N.Y. 1986)

[14] *Tews Funeral Home, Inc. v. Ohio Casualty Insurance Co.*, 832 F.2d 1037 (7th Cir. 1987); *Ruder & Finn, Inc. v. Seaboard Surety Co.*, 52 N.Y.2d 663, 422 N.E.2d 518 (1981); *Ethicon, Inc. v. Aetna Casualty & Surety Co.*, 737 F. Supp. 1320 (S.D.N.Y. 1990)

[15] *Lime Tree Village Community Club Ass'n. v. State Farm General Insurance Co.*, 980 F.2d 1402 (11th Cir. 1993); *American Guarantee & Liability Insurance Co. v. Vista Medical Supply*, 699 F. Supp. 787 (N.D. Cal. 1988)

[16] *Town of Stoddard v. Northern Security Insurance Co.*, 718 F. Supp. 1062 (D.N.H. 1989)

[17] *Blackhawk-Century City Sanitation Dist. v. American Guarantee & Liability Insurance Co.*, 856 F. Supp. 584 (D.Colo. 1994)

[18] *Pipefitters Welfare Educational Fund v. Westchester Fire Insurance Co.*, 976 F.2d 1037 (7th Cir. 1992)

[19] *Kitsap County v. Allstate Insurance Co.*, 964 P.2d 1173 (Wash. 1998)

competition claims[20], claims for misappropriation of trade secrets[21], and claims for trademark or patent infringement[22].

Conclusion

Generally, there is no downside to giving notice of claim to an insurance company. If the carrier accepts coverage, all the better. If not, the matter can be litigated with the insured's choice of counsel and according to the insured's wishes. Once the matter is concluded, the insured can decide whether or not to pursue a declaratory judgment action against its carrier. This decision will turn, in large part, on the result of the underlying business lawsuit and the costs expended in defending it.

However, if an insured does not give its carrier notice until after discovery has concluded, dispositive motions have been filed, or the case is settled, then the carrier may have a defense based on the notice requirements of the policy, and the insured may be stuck paying its own defense costs for the underlying litigation, notwithstanding the merits of its coverage position.

Examine business litigation complaints carefully, and, when in doubt, give notice early and often.

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[20] *Curtis-Universal, Inc. v. Sheboygan Emergency Medical Services, Inc.*, 43 F.3d 1119 (7th Cir. 1994)

[21] *Tradesoft Techs., Inc. v. Franklin Mutual Insurance Co.*, 329 N.J. Super. 137, 746 A.2d 1078 (2000)

[22] *Massachusetts Bay Insurance Co. v. Penny Preville, Inc.*, 1996 LEXIS 9671 (S.D.N.Y 1996); *Foundation for Blood Research v. St. Paul Marine & Fire Insurance Co.*, 730 A.2d 175 (Me. 1999); *Elan Pharm. Research Corp. v. Employers Insurance of Wausau*, 144 F.3d 1372 (11th Cir. 1998).