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The Impact Of Carolina Casualty

Law360, New York (July 28, 2009) -- A recent Texas decision has shed further light upon the scope of contract and insured-versus-insured exclusions and provides useful precedent for application of broad causation language.

A liability insurer that asserts a denial of liability coverage based upon a clear application of a policy provision early in the life of a case against an insured cannot assume that the matter will be concluded at that point, regardless of the soundness of the denial.

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complaint to nudge the allegations back into the scope of available insurance coverage.

While at times this exercise represents an understandable amendment of pleadings to conform to facts that may not have previously been articulated or viable theories of liability that had not been considered, at other times the exercise involves nothing more than a semantic attempt to deny the actual properties of the dispute, for the sole purpose of keeping insurance proceeds in play.

One avenue for avoidance of this cat-and-mouse pleadings game, where an insurer has clearly identified a risk that it is not willing to insure against, is to word exclusionary language broadly, so as to avoid any gray areas.

For this reason, certain exclusions in liability insurance policies are worded not only to apply to ³; EXW WR DQ\ PDWWHU ³EDVHG XSRQ ³DULVLQJ RXW
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Insurers have recently had a string of successes in this approach in the context of contract exclusions. Courts in several jurisdictions have applied contract exclusions beyond breach of contract claims, to include causes of action that clearly arise from contracts, but which were brought as tort claims or statutory claims.[1]

A recent addition to this line of cases is the ruling in Carolina Casualty Insurance Company v. James E. Sowell, et al., 603 F.Supp.2d 914, (N.D. Tex. 2009), which applied Texas law.[2]

The ruling also addresses the scope of the insured-versus-insured exclusion to a derivative lawsuit giving ri V H WR FHUWDLQ RI WKH LQVXUHG V ¶ FODLPV between claims brought by an insured from claims brought against an insured.

& DUROLQD & DVXDOW \ , QVXUDQFH & RPSDQ \ ³ & DUROLQD ´ IL in the Northern District of Texas in regard to a series of lawsuits brought in Louisiana DQG 7H [DV WKH ³XQGHUO \LQJ ODZVXLWV ´ ZKLFK FRQFHUC Hurricane Katrina.

Property insurance coverage for the warehouse was much less than the full amount of warehouse damage. The lessors and lessees of the property, and certain principals, directors or officers of each, were parties in a series of lawsuits brought to establish liability among themselves for failure to obtain sufficient insurance for the warehouse and ensuing damage for loss of use.

Carolina sought a declaration that it had no duty to defend or to indemnify individual and corporate insureds under a management liability insurance policy in connection with the lawsuits.

Carolina argued that coverage was precluded by contract, property and insured-versus-insured exclusions, and because certain of the claims were affirmative claims by insureds, rather than claims asserted against insureds.

All but one of the insureds counterclaimed to seek a declaration that Carolina had a duty to defend and to indemnify, and that it was liable for breach of contract, extra-contractual and statutory damages.

Contract Exclusion

The court agreed that coverage for the claims in two of four of the underlying lawsuits was precluded under the contract exclusion,[3] which states that Carolina:

"Shall not be liable to make any payment for Loss in connection with a claim made against any insured ... based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving any oral or written contract or agreement. This exclusion shall not apply to Coverage A. or Coverage C., in the event that such liability would have attached to an insured in the absence of the oral or written contract or agreement, or in the event a claimant alleges a breach of implied contract."

7 KH LQVXUHG V ¶ PDLQ DUJXPHQW DJDLQVW DSSOLFDWLRQ R confined to actual claims for breach of contract only and not claims sounding in tort or

brought under statute. As support, they cited *Admiral Insurance Co. v. Briggs*, 264 F.Supp.2d 460 (N.D. Tex. 2003).

In *Admiral v. Briggs* the insurer argued that a contract exclusion would apply to securities fraud/misrepresentation claim V E H F D X V H W K H F O D L P V K D G ³ L Q Y R C misrepresentations concerning a lease. The court in *Admiral v. Briggs* refused to apply the exclusion because the insurer had not established a sufficient causal relationship between the lease and the misrepresentation claims.

Judge Fitzwater distinguished *Admiral v. Briggs* from *Carolina v. Sowell* on the basis of the causation. In *Admiral v. Briggs* the lease was simply part of the context of the underlying lawsuit, and the misrepresentation claims against the insureds would have existed with or without it.

In *Carolina v. Sowell* each of the counts in the underlying lawsuits, whether for breach of contract, negligence or breach of statutory provisions, were dependent upon the lease.

The court further rejected an argument by one individual insured that the contract exclusion would not apply to breach of duty claims brought against him specifically as manager/supervisor of the lessees of the warehouse. He argued that the contract exclusion should not apply because he himself was not a party to the lease contract.

The court noted, however, that the language of the exclusion applies to any contract, not merely to contracts to which an insured is a party. Moreover, the alleged duty of the individual ² a duty to procure insurance for the leased warehouse ² F O H D U O \ ³ D U R V H ' from the lease contract, and therefore the claimed breach was excluded.

Insured -Versus -Insured Exclusion

One of the four underlying lawsuits was a derivative lawsuit filed by one of the insureds, James Sowell, who was also a shareholder of one of the insured entities known as ³ ' 2 8 6 '.

The derivative lawsuit asserted breach of fiduciary duty claims against DOUS and certain insured individuals in connection with their alleged failure to provide adequate insurance for the warehouse and alleged mismanagement of the litigation concerning the warehouse.

After the initial filing of the derivative lawsuit another DOUS shareholder, intervened as a plaintiff in the derivative lawsuit.

Caroli Q D F R Q W H Q G H G W K D W F R Y H U D J H I R U W K H L Q V X U H G V ¶ F lawsuit was precluded by an insured-versus-insured exclusion.

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right of the insured entity, RU E\ DQ\ GLUHFWRUV RU RIILFHUV

Although the insured-versus- LQVXUHG H[FOXVLRQ FRQWDLQV DQ H[FHSV
action by any security holder of the insured entity, but only if such claim is instigated
and continued totally independent of, and totally without the solicitation of, or assistance
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Carolina argued that the derivative lawsuit did not fall within the exception because it
was filed by James Sowell, an insured.

The court agreed, finding that the exclusion is unambiguous, and rejecting several
arguments by the insureds.

First, the insureds argued that there was no evidence that James Sowell was an
insured; however, since he had signed a policy renewal application as president of an
insured entity, this was clearly incorrect.

The insureds further argued that because the insured-versus-insured exclusion applies
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officers, the exclusion only applies when the party bringing the claim does so against
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The insureds contended that the language operates this way because it was drafted to
address only situations in which the parties might be acting collusively.

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the argument, it would fail, because the derivative claim had been brought by James
6RZHOO ³RQ EHKDOI Rfficer of DOUS, the same entity.

Moreover, the court noted that because the language of the exclusion was
unambiguous, the rationale giving rise to the language was irrelevant.

The insureds also argued that the derivative claim exception to the insured-versus-
insured exclusion would not apply because the derivative lawsuit was brought by James
Sowell as a shareholder on behalf of DOUS, and not by DOUS.

The court rejected the argument, because the limiting language of the exception states
that the exception does not apply unless the derivative claim is instigated and continued
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The involvement of the insured James Sowell in the derivative suit placed the claim
outside of the derivative claim exception.

Last, the insureds cited Federal Insurance Co. v. Infoglide Corp., 2006 WL 2050694
(W.D. Tex. July 18, 2006), to argue that the inclusion of an additional noninsured

intervenor plaintiff in the case would take the derivative claims outside of the insured-versus-insured exclusion, notwithstanding the involvement of insured James Sowell.

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insured-versus-insured exclusion to a case that had included claims of both insured and non-insured plaintiffs.

Judge Fitzwater again disagreed. Federal v. Infoglide involved direct claims of non-insureds. Direct claims do not fall within the derivative claim exception to the insured-versus-insured exclusion, so the independent claim issue was not a factor.

In Carolina v. Sowell, on the other hand, because the underlying lawsuit brought by James Sowell and the noninsured intervenor plaintiff were derivative claims, the limiting language of the exception would apply. Accordingly, because the derivative lawsuit involved James Sowell, an insured, it was excluded.

Claims by Insureds

One of the four underlying lawsuits for which the insureds sought coverage was filed by one of the insureds against the lessor of the property.

The court did not examine whether either contract exclusion or property loss exclusion would apply to the lawsuit because it ruled that the insureds had not met their threshold burden of establishing that the lawsuit could give rise to covered loss.

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insured entity arising from any claim first made against the insured entity during the
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A lawsuit by an insured, rather than against it, does not constitute a claim made against an insured. The court further noted that if the lawsuit had involved a claim brought against an insured, the insured-versus-insured exclusion would have applied, in any event.

Conclusion

The ruling in Carolina v. Sowell is instructive as to the application of contract and insured-versus-insured exclusions by addressing certain parameters of each under Texas law.

Perhaps more importantly, in a broader context, the Carolina v. Sowell decision serves as useful precedent for the application of any exclusion that is defined broadly using similar terms.

Such exclusionary language is to be applied according to the actual subject matter of a claim, rather than according to how the claim might be asserted.

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The opinions expressed are those of the author and do not necessarily reflect the views of Portfolio Media, publisher of Law360.

[1] See *Spirtas Co. v. Federal Insurance Co.*, 521 F.3d 833 (8th Cir. 2008), S.J. Amoroso Constr. Co. v. Executive Risk Indem. Inc., 2009 WL 1154202 (9th Cir. Apr. 30, 2009); *RODCO Worldwide Inc. v. Arch Specialty Insurance Co.*, 2009 WL 35006 (5th Cir. Feb. 23, 2009); *LUH, QV & R 5233867* (D.N.J. Dec. 12, 2008); *North Plainfield Board of Education v. Zurich American Insurance Co.*, No. 05-4398, 2008 WL 2074013 (D.N.J. May 15, 2008), GE HFS Holdings Inc. v. National Union Fire Insurance Co. of Pittsburgh, Pa., 520 F. Supp. 2d 213 (D. Mass. 2007); see also discussion of three of the foregoing cases in Joseph A. Pines, *Professional Liability Underwriting Society Journal*, November, 2008.

> @ 7H [DV ODZ UHTXLUHV DSSOLFDWLRQ RI WKH HLJKW FR to defend exists, i.e., a review of the four corners of the pleadings in the lawsuits brought against the insureds and the four corners of the insurance policy to determine whether any of the claims could potentially give rise to coverage. *GuideOne Elite Ins. Co. v. Fielder R. Baptist Church*, 197 S.W.3d 305, 308 (Tex. 2006). Texas courts will also find that the operation of the contract exclusion made it largely unnecessary for the court to analyze the application of the property loss exclusion.

[3] The court further indicated that a property loss exclusion in the policy would also make the operation of the contract exclusion made it largely unnecessary for the court to analyze the application of the property loss exclusion.