When a shield is a sword: an insurance company's duty to defend

By Jordan Stanzler and Deb Goodman

Commercial general liability (CGL) insurance policies provide indemnification and a defense to any alleged liability. This "duty to defend" is triggered by the filing of a claim (typically a complaint, counterclaim, or cross claim) against the policyholder that potentially seeks damages for certain covered events. See *Montrose Chemical Corp. v. Superior Court*, 6 Cal. 4th 287, 295 (1993). Once triggered, the insurance company pays for the cost of defense.

The duty raises interesting issues in the context of environmental remediation statutes, such as the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), where the statutory scheme explicitly contemplates that potentially responsible parties will pursue cross claims for contribution as a means of contesting or reducing an individual party's liability. See 42 U.S.C. Section 9613(f). Insurance companies often argue that the duty to defend does not extend to paying for the costs incurred by the policyholder in pursuing contribution claims.

At first blush, it may sound reasonable that a "duty to defend" would not include a duty to pay for so-called "affirmative relief." However, case law establishes that insurance companies have a duty to pay for affirmative relief when the affirmative relief is a means of reducing the policyholder's liability.

The classic explanation of coverage is found in *Great West Cas. Co v. Marathon Oil Co.*, 315 F. Supp.2d 879, 883 (N.D.Ill. 2003): "Defense" is about avoiding liability. Claims and actions seeking third-party contribution and indemnification are a means of avoiding liability just as clearly as is contesting the claims alleged to give rise to liability. A duty to defend would be nothing but a form of words if it did not encompass all litigation by the insured that could defeat its liability, including claims and actions for contribution and indemnification.

Courts have adopted this premise in a variety of contexts. The courts have held that the pursuit of affirmative relief is defensive in nature in three scenarios. The first is when the claim is "inextricably intertwined" with the defense and "necessary to the defense as a strategic matter." *Safeguard Scientifics Inc. v. Centercore Inc.*, 766 F. Supp. 324, 333-34 (E.D. Pa. 1991), reversed in part on other grounds, 961 F.2d 209 (3d Cir. 1992) (company-policyholder's noncompulsory counterclaims for breach and fraud were "inextricably intertwined" with the company's defense of a former corporate officer's defamation and breach of duty actions). See *Ultra Coachbuilders Inc., v. General Sec. Ins. Co.*, 229 F. Supp. 2d 284, 2889 (S.D.N.Y. 2002) (counterclaims asserted by policyholder in trademark infringement action were inextricably intertwined with policyholder's defense); *Aerosafe Int'l v. ITT Hartford of the Midwest*, 1993 U.S. Dist. LEXIS 10443, (N.D. Cal. 1993) (complaint and cross complaint were "part of an overall litigation strategy" to defend an allegation of misappropriation of trade secrets).

The second is when the policyholder's claim is made "in the resistance to the contention of liability." See *Simon v. Maryland Cas. Co.*, 353 F.2d 608, 613 (5th Cir. 1965) (government sub-contractor entitled to fees incurred in pursuing complaint against government because complaint was a measure to resist, i.e., defend, the contention of liability for damage where government withheld money owned under the contract to offset damages the contractor allegedly caused); *IBP Inc. v. National Union Fire Ins. Co. of Pittsburg*, 299 F. Supp. 2d 1024 (D.S.D. 2003) (policyholder's cross claim in one action was effectively an answer to the injured party's complaint asserted in another action); *Smart Style Indus. Inc. v. Pennsylvania Gen. Ins. Co.*, 930 F. Supp. 159, 161 (S.D.N.Y. 1996) (declaratory judgment action brought by policyholder was a defense to a trademark infringement claim where ownership of the trademark was contested).

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The third is when the policyholder prosecuted the claim "to limit or defeat liability." *Post v. St. Paul Travelers Ins. Co.*, 752 F. Supp. 2d 499, 513-16 (E.D. Pa. 2010) (draft complaint was part of policyholder's defense of malpractice action because it was prepared in anticipation of mediation, the purpose of which was to prevent the injured party from even filing suit). See *Oscar W. Larson Co. v. United Capital Ins. Co.*, 845 F. Supp. 458, 461 (W.D. Mich. 1993) (counterclaims and cross claims asserted by policyholder were necessary to limit or defeat liability where policyholder was sued for negligence); *TIG Ins. Co. v. Nobel Learning Communities Inc.*, 2002 U.S. Dist. LEXIS 10870 (E.D. Pa. 2002) (policyholder's declaratory judgment action was "essential" to policyholder's defense of copyright infringement claim because it could defeat or offset liability, and it was therefore "logically encompassed by [the insurance company's] duty to defend").

At least one court has invoked these principles in the context of CERCLA. In *Emhart Industries Inc. v. Home Ins. Co.*, 2006 U.S. Dist. LEXIS 63144 (D.R.I. 2006), the policyholder sued the insurance company for breach when the insurance company refused to defend the policyholder in an environmental remediation case. The insurance company filed a motion for summary judgment, contesting that if there was a breach, the insurance company would not be liable for costs the policyholder incurred in pursuing contribution claims against other potentially responsible parties. The court disagreed, recognizing that "a defense is about avoiding liability." Therefore, it continued, "seeking third-party contribution claims and indemnification are a means of avoiding liability just as clearly as is contesting the claims alleged to give rise to the liability." The court concluded that the policyholder's pursuit of other potentially responsible parties was "defensive in nature" in light of CERCLA's statutory liability and contribution scheme.

In sum, the costs for pursuing CERCLA contribution claims should be covered in the typical case where the policyholder files a contribution claim to reduce its liability. This outcome delivers the full protection of a defense to which the policyholder is entitled. Insurance companies should enthusiastically embrace the duty to defend in this context, since a successful claim for contribution reduces the liability of the policyholder and thereby reduces the amount of indemnity the insurance company may have to pay at the end of the day.

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