

A Posnerian Re-formation of Insurance Law

Lockwood International v. Volm Bag

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Introduction. Judge Richard Posner, who sits on the United States Circuit Court of Appeals for the Seventh Circuit (and who was formerly its Chief Judge) is, by almost universal acknowledgment, one of the truly brilliant and innovative minds in American law today. He was one of the founders, purveyors, and popularizers of the idea that economics was fundamental to the understanding and rational reconstruction of law.¹ He has written extensively on jurisprudence,² and he has considered the relationship between law and morality at some length.³ Not long ago, Judge Posner wrote a book on the Clinton impeachment and many think it will become a classic,⁴ and then one about the Bush-Gore election.⁵

Quite recently, Judge Posner was the court appointed mediator in the government's antitrust suit against Microsoft. And even more currently the CONNECTICUT INSURANCE LAW JOURNAL devoted most of an issue to a symposium on Posner's insurance jurisprudence.⁶ Even though one of the comments in the symposium issue concerns a case on sexually transmitted diseases, this symposium issue lacked either the space or the courage to consider directly

Judge Posner's views on insurance and sex, such as they are.⁷

When a first rate, possibly great, mind makes a mistake, it can be a howler. Judge Posner has done this in the opinion he wrote in *Lockwood International, B.V. v. Volm Bag Company, Inc.*, 273 F.3d 741 (7th Cir. 2001)[2001 WL 1549239]. Chief Judge Flaum and Judge Manion, neither a slouch, signed off on the opinion, which was issued on December 6, 2001. The case arose under Wisconsin law and was litigated in federal district court there. As is permitted under Wisconsin rules, the liability insurer for Volm, North River Insurance, intervened. The appeal concerned a summary judgment which the district judge had entered for North River and against Volm. The substantive tort case is still pending.

Underlying Case. Lockwood manufactured—or at least imported—machines for weighing and bagging produce, according to the opinion. Volm Bag was the exclusive distributor of these products for Lockwood in the United States. North River issued Volm a CGL policy with applicable limits of \$1 million.

1. Richard A. Posner, *ECONOMIC ANALYSIS OF LAW* (5th Ed. 1998). See Richard A. Posner, *THE ECONOMICS OF JUSTICE* (1983). See also Richard A. Posner, *ANTI-TRUST LAW: AN ECONOMIC PROSPECTIVE* (1978). (The second edition of this volume is due out shortly.) Also see Richard A. Posner, *FRONTIERS OF LEGAL THEORY* (2001). See William M. Landes and Richard A. Posner, *ECONOMIC STRUCTURE OF TORT LAW* (1987).

2. Richard A. Posner, *OVERCOMING LAW* (1995). See Richard A. Posner, *THE PROBLEMS OF JURISPRUDENCE* (1990).

3. Richard A. Posner, *THE PROBLEMATICS OF MORAL AND LEGAL THEORY*. Judge Posner, a former law professor, who still teaches now and then, is also becoming something of a social critic. See Richard A. Posner, *Strong Fiber After All*, 289 *ATLANTIC* 22 (Jan. 2002).

4. Richard A. Posner, *AN AFFAIR OF STATE: THE INVESTIGATION, IMPEACHMENT, AND TRIAL OF PRESIDENT CLINTON* (1999).

5. Richard A. Posner, *BREAKING THE DEADLOCK: THE 2000 ELECTION, THE CONSTITUTION AND THE COURTS* (2001).

6. See the essays following the introduction. Jesse A. Langer, *Symposium Introduction: Deciphering Posner's Insurance Jurisprudence*, 7 *CONN. INS. L. J.* 1 (2000-2001). Three substantial articles concern Judge Posner's insurance jurisprudence. Even the notes and comments concern cases he has decided and opinions he has written.

7. See Richard A. Posner, *SEX AND REASON* (1992). See also, Richard A. Posner and Katharine B. Silbaugh, *A GUIDE TO AMERICA'S SEX LAWS* (1998).

Apparently the CGL policy was standard in every relevant way. This means that there was no limit on defense expenses, and the insurer's payment of defense expenses did not reduce the limit.

Several years ago—perhaps six or seven of them—Lockwood sued Volm. The theories were breach of fiduciary duty, tortious interference with contract, unfair competition, and conspiracy. The gist of the factual allegations went something like this. Volm created a new company and named it Munter. In addition, Volm recruited—“lured” as Judge Posner put it—former Lockwood employees to work for Munter. Volm allegedly stole Lockwood's intellectual property and copied Lockwood's machines, apparently through Munter. Volm must have sold Munter products, because—according to Lockwood's allegations—it induced Lockwood's customer to forsake Lockwood products and instead buy Munter products through it. Allegedly, Volm also spread false rumors about Lockwood's financial stability, solicited orders on behalf of Lockwood and then substituted its machines (classic bait and switch, more characteristic of dealings with consumers than in B-to-B contexts), and told customers that Lockwood has stolen its patents, after—according to the complaint—those patents were obtained by fraud on the part of Volm.

Insurance Dimensions. As Judge Posner correctly observed, the Lockwood complaint triggered a duty to defend, as North River recognized. Coverage B in a standard CGL policy provides coverage for certain “offenses,” to use the language of the policy. They are divided into two categories: “personal injury,” which is *not* the same idea used in substantive tort litigation generally (as in “personal injury lawyer”) and “advertising injury,” where coverage is restricted to a range of offenses committed in the course of advertising the insured's goods or services. (The “personal injury” offenses covered in the policy are not similarly restricted, except that they may not occur in the course of advertising.)

The personal injury offenses relevant here are slander and libel. The advertising offenses relevant here are slander and libel, product disparagement, misappropriation of a style of doing business, and

perhaps some sort of copyright or patent infringement, either of which might be an infringement of title. “[T]he complaint expressly charged disparagement of Lockwood and its products, and strongly implied (especially in the bait and switch allegation) that Volm had appropriated Lockwood's ‘advertising ideas or style of doing business[.]’” The court assumed, apparently as the insurer had, that the solicitation of customers and sales constituted a form of advertising. The court certainly did not discuss the issue, which suggests that the insurer had not made an issue of the matter.

Insurer Actions. Four years into the case North River paid Lockwood \$1.5 million to file an amended complaint deleting the covered claims. These included disparagement, defamation, misappropriation of advertising ideas or style of doing business, copyright infringement, and several other causes of action. Under the terms of the Lockwood-North River agreement, to which Volm was not a party, the full \$1.5 million would be credited toward reducing to any liability Volm was ultimately found to have. The agreement further provided that Lockwood would not undertake to prove that “Volm caused Lockwood's customers to believe that Lockwood products infringed Volm's patent.” No doubt the agreement contained other provisions as well.

North River then filed a motion for summary judgment seeking a declaration that it had no further duty to defend. The district court granted the motion, and Volm appealed. Since that component of the case constituted a full adjudication between Volm and North River, Volm appealed and the Seventh Circuit took the cases.⁸

Holdings. The opinion of the circuit panel should be understood as involving four holdings, although they are not so denominated. First, North River breached its duty to defend by manipulating the plaintiff's pleadings. Second, North River breached its duty to defend for assuming that the duty to defend under Coverage B is triggered by offenses alleged rather than facts alleged. Third, defending liability insurers have fiduciary duties to defended insureds, and North River breached those duties. Judge Posner was outraged. “We have difficulty imagining a more

8. Judge Posner is an acknowledged expert on the jurisprudence of federal jurisdiction and the structure, function, and law of federal courts generally. See Richard A. Posner, *THE FEDERAL COURTS: CRISIS IN REFORM* (2d Ed. 1999).

conspicuous betrayal of the insurer's fiduciary duty to its insured than for its lawyer to plot with the insured's adversary a repleading that will enable the adversary to maximize his recovery of uninsured damages from the insured while stripping the insured of its right to a defense by the insurance company." (Remember the word "maximize"!)

Fourth, North River's opportunistic conduct constituted insurance bad faith.

Reasoning. Judge Posner acknowledged that North River had a right to settle all or part of Lockwood's suit against Volm. It had a right to do this under the insurance contract without Volm's consent. What it did not have a right to do, he said, was to help Lockwood transform the potentially covered claims pleaded into ostensibly non-covered claims (apparently newly pleaded in the amended complaint). To do this is not just to settle a lawsuit, it is to injure an insured.

Critique. There is another way to look at what happened, at least if Judge Posner's opinion tells the whole story. (And his prose is my only source.)

North River settled all the covered claims. It did not do this in a usual way, i.e., by an agreement signed by the parties to the underlying case together with (partial) releases. It achieved a settlement, nevertheless. Judge Posner acknowledges this fact. It also entered into an agreement which required Lockwood not to prove (or try to prove) facts which would amount to the proof of possibly covered claims. (Unfortunately the scope of that agreement is not clear from the court's opinion.) North River paid more than policy limits to achieve this agreement, and then obtained a further agreement.

Lockwood also agreed to credit the entire settlement figure against any judgment it got against Volm on the uncovered claims. Thus, North River bought the covered claims, thereby extinguishing them, and bought another \$1.5 million reduction in uncovered Volm liability (assuming it had any). Thus, North River got its insured two reductions in potential liability for the price of one. Given what North River did, therefore, it is not possible that the insurer assisted the tort plaintiff in *maximizing* its recovery on non-covered claims, as Judge Posner suggested. Indeed, North River restricted Lockwood's monetary recovery.

Judge Posner accuses North River of helping Lockwood reformulate covered into non-covered

claims. There is nothing specific in the opinion to suggest that or how this was done. Then again, of course, judicial opinions are not student term papers or end-of-term exams in which every assertion applying law to facts must be explicitly supported. Still, the lawyers in the underlying case were probably not ill-informed fools, and if the case was pleaded half-way decently, North River's lawyer would probably have nothing new to add. I suspect s/he worked hard to get everything potentially covered out of the pleading to protect the insured and to effectuate the spirit and letter of the settlement agreement. (That is what most insurance lawyers do when confronted with situations like this one—a relative rarity, in any case.)

After all, North River had settled the covered claims. They needed to be eliminated from the complaint. The pleading needed to be wiped clean of reference to those theories and any facts which spoke only to those offenses. (Of course facts which also address non-covered claims appropriately may stay, as long as they are not "snucc" in later to try to prove up a covered claims.) Given the fact that Volm was none too happy about North River's payment and probably refused to participate in the negotiations, it is not surprising that North River's lawyer had to monitor the repleader of the complaint. Nothing in Judge Posner's opinion supports the conclusion that North River's lawyer "screwed" North River's insured.

Judge Posner poses a hypothetical, however. Suppose *P* sues *D* and states two covered claims. Suppose further that *D*'s insurer, *I*, which has limits of \$1 million, goes to *P* and offers \$1.5 million if *P* will drop one of its covered claims and transform the other into a non-covered claim.

The only purpose of such an offer, suggests Judge Posner, is to relieve *I* of its obligation to defend *D*, and this is improper. One suspects that Judge Posner is right, if *P* could recover on both non-covered claims. The conduct of *I* is improper and perhaps constitutes some sort of tort, as well as a breach of the duty to defend. Judge Posner likens it to a bribe. The trouble is that there is nothing in his opinion to suggest that North River did this or anything like it. The opinion suggests that North River settled offenses which would have been covered, if proved. It paid policy limits, and then some, made sure that no vestige of the covered claims were left over, contractually obligated Lockwood not to sneak those

claims in again, and terminated its defense. If this is what happened, and it's all that happened, one has difficulty seeing what is wrongful here.

Judge Posner also seems to think that North River has somehow missed an important fact. The duty to defend, he says, is triggered by the facts which are alleged and not the causes of actions asserted, i.e., by offenses stated. This has certainly been the rule for most the Twentieth Century, but the rule developed when liability insurance amounted only to what is now called Coverage A, i.e., coverage for bodily injury and property damage caused by accidents or accidentally created conditions. As Judge Posner observed in his opinion, albeit in another context, the scope of a rule is partially determined by its rationale. The rule that factual pleadings determine the duty to defend has its natural habitat in Coverage A. In Coverage B, where offenses trigger coverage, fact pleadings should not trigger the duty to defend; the pleading of an offense, i.e., a cause of action, should. Clearly, the triggering cause of action need not be explicitly named, and insurers should not be able to use hyper-technical pleading defects to avoid providing a contractually mandated defense, but here, where a cause of action was explicitly deleted and perhaps barred by name, the duty to defend based upon them should evaporate.

Judge Posner also assumed that if facts were pleaded here and there in Lockwood's amended complaint which in the aggregate added up to the pleading of a potentially covered offense, then North River would have a continuing duty to defend even after it paid its \$1.5 million. This assumption is wrong. The standard CGL policy specifically provides that if policy limits have been paid in settlements, then the insurer has no further duty to defend. Of course, that is exactly what happened here. If North River paid its policy limits to get its insured immunized against liability for at least some covered claims, and if the sums paid were reasonable under the circumstances, then North River should be able to withdraw and "go home." This is true even if not all covered claims were settled. Here, of course, it looks like all of them were settled.

Further Critique. There are several other

propositions in the *Lockwood* opinion which bear further thought. First, it is stated as a matter of uncontroversial law that defending insurers are fiduciaries of their insureds. This proposition is not accepted in most states and is controversial. Many states deny this legal claim. Second, Judge Posner asserts that every contract—and hence every insurance contract—implies a duty of good faith (and fair dealing?) in its performance. Some jurisdictions specifically deny exactly this claim—Texas, for example. Third, and finally, the opinion posits that "if defense costs are readily apportionable between the covered and uncovered claims, the insurance company need pay only for the former." This third proposition is certainly not even close to the majority rule, although—perhaps—it should be.

Concluding Speculations. Insurance bad faith is often defined as denying or delaying the payment of claims without an arguably good reason. Wisconsin pioneered the idea that bad faith was claims error for which there was no fairly debatable reason. It is not clear that North River's conduct meets this standard, just as it is not clear that North River breached its contract of insurance. It appears that Judge Posner is deeply offended by North River's conduct and that this reaction is his implicit standard of insurer bad faith here. One can think of far worse standards, but his rule is certainly not the law of Wisconsin.

Judge Posner is writing an opinion designed to reform and trans-form insurance law. Like many great common law opinions he is working his will by writing as if his revolutionary observations are already accepted doctrine. Judge and then Justice Cardozo also wrote like this, sometimes, and it should be remembered Judge Posner wrote an exquisite little book appreciating his great predecessor.⁹ Still, a number of the legal propositions Posner proposes are not the law and should not become so.

Of course, the last word has not been spoken on the insurance aspects of this case. Suppose rehearing is sought and denied; the Seventh Circuit judgment becomes final; the mandate is issued; and the case goes back to the trial court. All that has happened is that summary judgment has been reversed. Perhaps, North River should try again. Given the tone of the

9. Richard A. Posner, *CARDOZO: A STUDY IN REPUTATION* (1990). There are many parallels between Posner and Cardozo. For example, both of them appreciated the connection between law and literature. Richard A. Posner, *LAW AND LITERATURE* (Rev. Ed. 1998).

Posner opinion, one doubts that the district judge will enter another. Perhaps Volm will try. Its motion too might be denied. If so, then North River should defend under a (new and expanded?) reservation and seek a refund of all defense expenses after a full trial on the merits of the insurance issues in which North River tries to prove that it did none of the nefarious things attributed to it.

That coverage trial might be interesting. No doubt it would be separated from the underlying trial.

What might the proof in the insurance case look like? It is worth speculating that Volm was not an easy insured to work with, and I would not be surprised if the adjusters at North River were not at their wit's end. (Of course, this is only idle speculation, as the above subtitle indicates.) If so, then if North River's conduct was otherwise acceptable and lawful, its withdrawal may not look like an cowardly abandonment. (Just a guess.) Who knows? The jury might even sympathize with the insurer.