

INSURANCE LITIGATION™

Reporter

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Agents & Brokers

Mississippi Supreme Court Limits Life Insurance Agent's Recovery from Insurer for Breach of Duty to Indemnify, Prohibits Recovery of Emotional Distress Damages and Punitive Damages

Court Eschews Historical Standard for Determining Principal's Duty to Indemnify Agent in Favor of Standard Set Fourth in Restatement (Third) of Agency

General American Life Insurance Company v. McCraw, ___ So.2d ___, 2007 WL 1631053 (Miss. June 7, 2007)

Case at a Glance

Under Mississippi law and the Restatement of Agency (Third), a life insurance company is obligated to indemnify its agent if the agent suffers a loss that fairly should be borne by the life insurer. The life insurer's indemnification obligation includes costs and fees the agent incurs in defending a policyholder's fraud action and in establishing the life insurer's duty to indemnify. However, indemnification is limited to reimbursement of those fees and expenses that are actually incurred and does not include other damages, such as damages for emotional distress or punitive damages.

Summary of Decision

Facts, Procedure, and Procedural Standards. Helena Jones bought a Great American Life Insurance Company (GrAm) "vanishing premiums" life policy through McCraw. She later sued both GrAm and McCraw for, among other things, fraud in connection with her purchase of the policy. McCraw requested a defense from GrAm. After GrAm refused McCraw's request, McCraw sued GrAm by means of a crossclaim based on what must have been a tort theory, since he sought damages for emotional distress and punitive damages.

A jury returned verdicts in favor of both Jones and McCraw, awarding McCraw \$150,000 in compensatory

damage and \$1 million in punitive damages. GrAm settled with Jones, and sought a JNOV against McCraw. The trial court granted the requested JNOV as to the punitive damage award, but declined to overturn the jury's compensatory damage award.

GrAm appealed as to the actual damages, while McCraw cross-appealed the JNOV on punitive damages. The Mississippi Supreme Court reversed the award of actual damages and affirmed the JNOV as to punitive damages.

Legal History. In addressing the fundamental question of whether GrAm had a duty to indemnify McCraw, the Mississippi Supreme Court reexamined and revised Mississippi law. A principal's duty to indemnify its agent is not automatic, but depends on certain factors being met. In 1987, the Mississippi high court, in *Mutual Life Insurance Company of New York v. Wesson*, 517 So.2d 521, 535 (Miss. 1987), adopted §439 of the Restatement (Second) of Agency and ruled that an insurer has a duty to indemnify its agent against the cost of defending a policyholder's lawsuits only if the insurer authorized the conduct of the agent and the defense against the suit was successful. Courts, however, found the Restatement (Second) rule difficult to follow, leading to a revised rule in the Restatement (Third) of Agency. In *McCraw*, the supreme court found that the "modern approach" embodied in the Restatement (Third) "is more streamlined in its application than the previous test we adopted in *Wesson*, and provides better guidance to trial courts and practitioners in determining when indemnity is warranted. Accordingly, we adopt the Restatement Third approach to determining whether there is a duty to indemnify between a principal and an agent[.]" By this decision the Court "abandoned," i.e., overruled at least part of *Wesson*.

Restatement (Third) of Agency. Significantly, the court embraced § 8.14 of the Restatement (Third) in its entirety, even though only a portion of it applied to McCraw's indemnity claims. Here is its language:

A principal has a duty to indemnify an agent

(1) in accordance with the terms of any contract between them; and

(2) unless otherwise agreed,

(a) when the agent makes a payment

(i) within the scope of the agent's actual Authority, or

(ii) that is beneficial to the principal, unless the agent acts officiously in making the payment; or

(b) when the agent suffers a loss that fairly should be borne by the principal in light of their relationship.

As the court acknowledged, of the four ways to establish that an agent is entitled to indemnification from a principal, only subsection §(2)(b) applies to the GrAm-McCraw situation. By way of clarification, the court expressly adopted comment d to § 8.14, which states that an agent is not entitled to indemnity if the agent does something which is *unauthorized* and the principal does *not* benefit. The court also analyzed the allocation of decision-making responsibility between the court and the jury, although it did so in a conclusory manner that left several questions unresolved. Specifically, the court stated that both the question of whether McCraw was acting within his authority and the question of whether McCraw suffered a loss which should fairly be borne by GrAm are questions for the jury. Is whether the agent's conduct benefitted the principal also a jury question? Is the concept of *fairness* found in §8.14(2)(b)—a normative, as opposed to fact issue—also within the province of the jury?

Damages Recoverable. Having adopted a new standard of determining a right to indemnification, the court turned to the scope of permissible recovery in actions by an agent against a principal. In so doing, the court got to the heart of the theoretical underpinnings of a principal-agent indemnity. The court described indemnity in this context as "a form of reimbursement, generally for legal fees," and expressly eschewed McCraw's attempt to analogize GrAm's conduct to the tort of insurance bad faith. Thus, the most McCraw could recover were the fees and costs incurred in defending the underlying action and in pursuing indemnification. Punitive damages and emotional distress damages, recoverable by policyholders in actions for breach of the implied covenant of good faith and fair dealing, are not recoverable by agents in indemnification actions against their principals.

Remand. The Mississippi Supreme Court remanded the case for a determination of whether GrAm owed a duty to indemnify under the new standard adopted by the court, and, if so, the attorney fees and costs incurred by McCraw in defending the Jones lawsuit and in vindicating his right to reimbursement.

Comments

Several points should be made. The first of them is hard, and will require some speculation. I will take the hard one first.

First, lawyers for the McCraw presented this case based in an imaginative but ultimately obvious fallacy. They maintained that if an insurer has a duty to indemnify a person for legal costs in defending a case, the insurer has a duty to defend. Under this approach, the duty to defend must be understood just as the words "duty to defend" are understood in the context of the insurance industry, so that GrAm's duty to defend McCraw was just like what it would have been had GrAm been McCraw's E & O liability carrier. Tort-based damages are recoverable from a liability insurer for breach of its duty to defend, said McCraw's lawyers, so they also are recoverable here.

Wrong said the Mississippi Supreme Court, and for four reasons. (i) The issue here is not a duty to defend. It is a duty to provide indemnification with respect to defense costs. (ii) The alleged analogy between the duty to defend under liability policies and life insurers' duty to indemnify their agents simply will not work. Life insurance policies are not liability policies, and agents are not insureds of life insurers with respect to errors and omissions. (iii) In liability insurance there is a sharp distinction between the duty to defend and the duty to indemnify. In the context of principal-agent indemnification, there is no such distinction. They duty to indemnify pertains to paying for a defense. (iv) The issue here is not damages. It is reimbursement. Tort damages like mental anguish and punitive damages are not a form of reimbursement.

But isn't the court failing to use its imagination here? Isn't it failing to adopt legal changes—alterations in legal theory—which need to be embraced? The jury assessed a million dollars in punitive damages. Hence, the chances are very good that GrAm did something very offensive. If its acts and

omissions are that offensive to good and solid citizens, the chances are that they are outrageous. If so, they need to be brought under legal control. If legal control requires a new legal theory, so be it.

Then again, if there is fault here, perhaps it is that of the plaintiff's lawyers. Instead of trying to angle their way into big damages by sliding one type of responsibility (reimbursement) into another (insurer bad faith) perhaps they should have outright argued for a new type of cause of action: *grossly negligent refusal to provide obligatory reimbursement*, or something of the sort.

Second, the law of reimbursement is not easy to think about. Where does it fit, into the law of remedies? Basically, the court here implies that it is not a species of damages. If it were, it would be more clearly attached to a set of causes of action. The only cause to which reimbursement-taken-alone could be attached, if it were a type of damages, is *implied contract*, but the court seems not inclined in that direction. So, would reimbursement constitute a species of restitution? But the major treatises of this topic do not discuss it, much less place it in the restitution system. Besides, how could a failure to reimburse be classified a type of unjust enrichment?
// Quinn