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Insurance co.'s duty to defend doesn't include counterclaim

SJC rejects expansion of 'in for one, in for all' rule

By: Pat Murphy June 29, 2017

An employment practices liability policy that specified a duty to "defend any claim" did not require the insurance carrier to bear the cost of a compulsory counterclaim against a former employee who sued the insured for wrongful termination, the Supreme Judicial Court has ruled in a 5-2 decision.

The defendant policyholder, Visionaid, Inc., argued that the duty to defend under the language of the policy encompassed any steps a reasonable defense attorney would take to reduce the liability of the insured, including the litigation of a counterclaim "inextricably intertwined" with the underlying liability claim.

But the SJC disagreed. In answering certified questions from the 1st U.S. Circuit Court of Appeals, the SJC concluded that the plain meaning of the policy did not impose such an obligation on the plaintiff insurer, Mount Vernon Fire Insurance Co.

"Visionaid and Mount Vernon entered into a contractual agreement that Visionaid would pay a certain amount of money to insure against a particular risk," Justice Frank M. Gaziano wrote for the majority. "The agreement in this case, memorialized in the written insurance policy, required Mount Vernon to 'defend' Visionaid in any claim 'first made against [it] during the Policy Period,' and no more."

Chief Justice Ralph D. Gants wrote a dissent joined by Justice Barbara A. Lenk. Gants criticized the majority for adopting a "narrow" view of the duty to defend, particularly given that the insurance policy at issue further obligated Mount Vernon to defend its insured in "any proceeding."

"Where the insured's defense is intertwined with a compulsory counterclaim, where any reasonable attorney defending that proceeding would bring such a compulsory counterclaim, and where the insured agrees that any damages awarded to the insured on that counterclaim will offset any award of damages against the insured that the insurer is required to indemnify, I conclude that an insurer's duty to defend the insured in 'any proceeding' includes the duty to prosecute such a compulsory counterclaim," Gants wrote.

The 30-page decision is *Mount Vernon Fire Insurance Company v. Visionaid, Inc.*, Lawyers Weekly No. 10-108-17. The full text of the ruling can be found here.

'Bright-line rule'

The decision provides a "bright-line rule" rule as to an insurer's duty with respect to counterclaims, according to Boston attorney Scarlett M. Rajbanshi, who with James J. Duane III represented the plaintiff insurance company.

"The majority correctly recognized the policy only provides coverage for claims asserted by third parties against Visionaid," Rajbanshi said. "The policy was not written, priced, or intended to fund prosecution of affirmative claims by the insured."

Kenneth R. Berman of Boston was counsel for the defendant policyholder. Berman did not respond to a request for comment.

Marshall N. Gilinsky of New York City represented amicus United Policyholders, a consumer advocate representing the interests of insureds. Gilinsky said an insurance carrier's duty to defend should encompass counterclaims when one looks at the underlying purpose of liability policies.

"At oral argument, the attorney for the insurance company conceded it would have been negligent for the defense attorney not to file the counterclaim," Gilinsky said. "If you have to file a counterclaim, and it's wrapped up in the defense of the claim against the policyholder, isn't that part of what it means to 'defend'?"

Gilinsky expressed concern that the SJC's decision "drives a wedge" between the policyholder and its carrier.

"Actions that clearly advance the defense of the policyholder are now no longer the responsibility of the insurance company," Gilinsky said.

But according to Boston attorney Rosanna Sattler, who represented amicus American Insurance Association, the SJC's decision rests on and reaffirms well-established contract principles recognized in Massachusetts and most states.

"It's been pretty clear for years that when you buy insurance and the underwriters determine what the premium is going to be, the contract is to defend a proceeding or case that is brought against the insured," Sattler said.

Michael F. Aylward filed an amicus brief in the case on behalf of the Massachusetts Insurance Federation and American International Group. The Boston attorney said the insurance industry saw the case as being important because it had the potential for expanding the duty to defend to new kinds of claims, raising costs for insurance companies.

However, Aylward said the SJC was correct in declining to read the duty to defend as broadly as the insured argued.

"The way the court went is straightforward: You *defend* something," Aylward said.

Boston litigator Robert W. Stetson said he sees the decision as creating a "clear rule" consistent with both the plain meaning and common understanding of the word "defend" as used in insurance policies.

Going forward, Stetson said, insurance defense attorneys will need to be "hyper-vigilant" about their obligation to consult with their clients, the insureds, when there is an issue concerning compulsory counterclaims.

"They are going to have to make it abundantly clear at the outset that they have not been retained to pursue counterclaims and that it is incumbent on the insured to hire their own attorney — or perhaps pay them — to prosecute compulsory counterclaims, or else they're going to lose the right to pursue them at a later date," he said.

Wrongful-termination claim

The plaintiff insurance carrier issued an employment practices liability insurance policy to the defendant. The policy covered wrongful-termination claims brought against the defendant from May 2011 through May 2012.

Under the terms of the policy, the plaintiff had "the right and duty to defend any Claim to which this insurance applies." The policy defined "claim" as "any proceeding initiated against [the defendant] ... seeking to hold [the defendant] responsible for a Wrongful Act."

In October 2011, the defendant terminated an employee after an audit uncovered evidence that he had misappropriated company funds. Claiming age discrimination, the employee filed a complaint for wrongful termination with the Massachusetts Commission Against Discrimination in August 2012.

The plaintiff appointed a panel attorney to represent the defendant before the MCAD. In February 2013, the employee sued the defendant for wrongful termination in Superior Court, dismissing the MCAD action. The plaintiff appointed a panel attorney to represent the defendant employer in the lawsuit. However, this time the plaintiff provided the defense under a reservation of rights.

The defendant demanded that counsel file a counterclaim against the employee for misappropriation of funds, asserting that if he did not, the defendant would exercise its right under the reservation of rights to retain independent counsel.

The plaintiff responded by withdrawing its reservation of rights while asserting the policy did not require it to pursue the counterclaim for misappropriation. The plaintiff also filed a declaratory judgment action in U.S. District Court for a determination of its obligations under the insurance policy.

Judge Nathaniel M. Gorton ruled that the plaintiff's duty to defend did not require it to prosecute the counterclaim against the defendant's former employee.

The defendant appealed to the 1st Circuit, which certified three questions to the SJC. The first asked whether under the insurance contract or the Massachusetts "in for one, in for all" doctrine an insurer is required prosecute a counterclaim on behalf of the insured when the policy provides that the insurer has a "duty to defend any claim."

The second asked whether, under such circumstances, a duty to defend arose when the insurance contract required the insurer to cover "defense costs" or "reasonable and necessary legal fees and expenses incurred" by the insurer from the "defense" of a claim.

Finally, assuming there was a duty to prosecute the defendant's counterclaim, the 1st Circuit asked whether a conflict of interest arose affording the defendant a right to independent counsel at the plaintiff's expense.

Narrow duty to defend

In answering the certified questions, Gaziano first addressed the scope of the plaintiff's duties under the terms of the insurance contract. Gaziano observed that while the policy defined "claim," it did not define the term "defend."

Giving the term its plain meaning, Gaziano wrote that "in the language of Visionaid's contract, the essence of what it means to defend is to work to defeat a claim that could create liability against the individual being defended."

Concluding that the insurance contract's language was clear and unambiguous, Gaziano found unavailing the defendant's policy arguments for interpreting the plaintiff's duty to defend broadly to encompass bringing an affirmative counterclaim on behalf of its insured.

The defendant argued that the duty to defend under its policy should be interpreted to mean anything a reasonable defense attorney would do to reduce the liability of the insured.

But Gaziano wrote that such an interpretation would require reading into the contract a number of terms the parties themselves did not include. In addition, he said such an interpretation would invite litigation over whether claims were sufficiently intertwined to trigger the duty to defend under a "reasonable defense attorney" standard.

Next, he rejected the defendant's argument that the "in for one, in for all" rule applied. The rule generally requires that when an insurer has a duty to defend an insured on one claim, the insurer must defend on all claims, including those not covered by the policy.

Gaziano concluded the rule did not apply in the context of counterclaims.

"While the 'in for one, in for all' rule did expand the class of actions that an insurer is obligated to defend, it did not change the meaning of the word 'defend,'" Gaziano wrote.

Accordingly, in answering the first certified question, the court held that "an insurer with a contractual duty to defend an insured is not required to prosecute an affirmative counterclaim on the insured's behalf, pursuant either to the contractual language in the policy at issue or the common-law 'in for one, in for all' doctrine."

The court likewise answered the second certified question in the negative, concluding "the duty to pay defense costs has the same scope as the duty to defend, and thus does not require an insurer to pay the costs of prosecuting a counterclaim on behalf of the insured."

The resolution of the first two questions meant there was no need to reach the 1st Circuit's third question.

Link:

http://masslawyersweekly.com/2017/06/29/insurance-co-s-duty-to-defend-doesnt-include-counterclaim/