Pennsylvania

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What triggers an insurer's duty to defend?

An insurer has a duty to defend its insured if the factual allegations of the underlying complaint "encompass an injury that is actually or potentially within the scope of the policy." *American & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 606 Pa. 584, 609, 2 A.3d 526, 541 (2010) (citations omitted). This is determined by "comparing the four corners of the insurance contract to the four corners of the complaint." *Id.* (citation omitted). Therefore, "an insurer may not justifiably refuse to defend a claim against its insured unless it is clear from an examination of the allegations in the complaint and the language of the policy that the claim does not potentially come within the coverage of the policy." *Id.* (citations omitted). "[W]here the insurer believes that coverage does not exist, the insurer should deny coverage to 'allow the insured to control its own defense without breaching its contractual obligation to be defended by the insurer.' We further encourage insurers to seek declaratory relief to eliminate the uncertainty regarding its responsibility for continued defense and ultimately for indemnity coverage." *Babcock & Wilcox Co. v. Am. Nuclear Insurers*, No. 2 WAP 2014, 2015 Pa. Lexis 1551, at *30 (Pa. July 21, 2015) (quoting *Jerry's Sport Ctr.*, 606 Pa. at 611, 2 A.3d at 542).

An insurer must look at the nature of the facts alleged, not the label of the causes of action asserted, to determine if the duty to defend is triggered. *See Mutual Benefit Ins. Co. v. Haver*, 555 Pa. 534, 538–39, 725 A.2d 743, 745 (1999) ("The particular cause of action that a complainant pleads is not determinative of whether coverage has been triggered. Instead it is necessary to look at the factual allegations contained in the complaint."); *QBE Ins. Corp. v. M & S Landis Corp.*, 2007 PA Super 12, ¶7, 915 A.2d 1222, 1225 (2007) ([T]o determine if there is coverage, we must look to the *facts* alleged in the underlying complaint, not the cause of action pled."), *appeal denied*, 598 Pa. 769, 956 A.2d 436 (2008). When considering whether there is a duty to defend, the factual allegations of the complaint against the insured must be accepted "as true and liberally construed in favor of the insured." *Jerry's Sport Ctr.*, 606 Pa. at 610, 2 A.3d at 541 (quoting *Frog, Switch & Mfg. Co., Inc. v. Travelers Ins. Co.*, 193 F.3d 742 (3d Cir. 1999)). In addition, all doubts and ambiguities in policy language must be resolved in favor of the insured. *Id.* at 608, 2 A.3d at 540 (citations omitted).

The language of the notice provision in the policy at issue and the facts surrounding the notice will determine the sufficiency of notice to trigger a duty to defend. Where a notice provision required notice to be given "by or on behalf of the insured," the Superior Court held that the notice sufficient to trigger a duty to defend may be given by "any reliable source." *Philadelphia Electric Co. v. Aetna Cas. & Sur. Co.*, 335 Pa. Super. 410, 484 A.2d 768 (1984) (holding notice through a co-insured constituted notice of a claim). That is, "notice of the accident need not come directly from the insured to effectively alert the insurer of its duty to defend." *Id.* at 415, 484 A.2d at 771 (recognizing this as general consensus reached by other jurisdictions and citing cases). As a result, an insurer generally may not disclaim a duty to defend based on the method of notice "unless it is *perfectly clear* that it was not given actual or constructive notice of the claim confronting it." *Id.* at 418, 484 A.2d at 772 (emphasis in original). Additionally, for an insurer to disclaim a duty to defend under an occurrence policy on grounds that it received late notice of the claim, it must show that it was prejudiced by the late notice. *Brakeman v. Potomac Ins. Co.*, 472 Pa. 66, 371 A.2d 193 (1977). Prejudice is not required under a claims-made policy. *ACE*

Am. Ins. Co. v. Underwriters of Lloyds & Co., 2007 PA Super 392, 939 A.2d 935 (2007), *aff'd w/o opin.*, 601 Pa. 95, 971 A.2d 1121 (2009).

What type of proceedings must an insurer defend?

This largely depends on the specific language of the policy at issue. "[A]n insurer's duty to defend is purely contractual, and an insurer has no duty to defend unless the obligation is expressed in the policy." *Genaeya Corp. v. Harco Nat'l Ins. Co.*, 2010 PA Super 33, ¶8, 991 A.2d 342, 347 (2010) (citing 1 Barry R. Ostrager & Thomas R. Newman, *Handbook on Insurance Coverage Disputes* §5.01[a] (14th ed. 2008)). Under a commercial general liability policy, an insurer typically agrees to defend an insured against any "suit," and suit is usually defined to mean "a civil proceeding in which damages because of 'bodily injury,' 'property damage,' 'personal injury,' or 'advertising injury' to which this insurance applies are alleged." *See*, *e.g.*, the policy discussed in *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 589 Pa. 317, 332, 908 A.2d 888, 897 (2006). Under that or similar language, an insurer has a duty to defend a lawsuit filed against the insured seeking damages covered under the policy. *See*, *e.g.*, *Penn-America Ins. Co. v. Peccadillos, Inc.*, 2011 PA Super 176, 27 A.3d 259 (2011), *appeal denied*, 613 Pa. 669, 34 A.3d 832 (2011). Other types of policies might have different language regarding what the insurer agrees to defend or might not contain an agreement to defend.

Pennsylvania courts have held that a potentially responsible party ("PRP") letter received from the United States Environmental Protection Agency does not constitute a "suit" and, therefore, does not trigger a duty to defend. *See Simon Wrecking Co. v. AIU Ins. Co.*, 350 F. Supp. 2d 624 (E.D. Pa. 2004) (predicting that the Pennsylvania Supreme Court would hold that a PRP letter does not constitute a "suit," where that term was not defined in the policy, and, thus, did not trigger a duty to defend; noting "the duty to defend extends only to suits and not to allegations, accusations or claims which have not been embodied within the context of a complaint"); *Sunoco, Inc. v. Illinois Nat'l Ins. Co.*, No. 04-4087, 2006 U.S. Dist. Lexis 95605 (E.D. Pa. Dec. 27, 2006) (holding that a PRP letter did not constitute a "suit" within the meaning ascribed in the policy), *rev'd in part on other grounds*, 226 F. App'x 104 (3d Cir. 2007).

In *Post v. St. Paul Travelers Ins. Co.*, 691 F.3d 500 (3d Cir. 2012) (applying Pennsylvania law), a case with a complex factual background, the court held that a letter from a client to its lawyer blaming the lawyer for exposing the client to uninsured punitive damages and forcing it to settle a case to avoid exposure constituted a "claim"—which was defined as a "demand that seeks damages"—triggering a duty to defend under the lawyer's professional liability insurance policy where the policy imposed a "duty to defend any protected person against a claim or suit." *Id.* at 519. The court further held that a petition for sanctions filed by the underlying plaintiff against the lawyer in the underlying lawsuit was not a "suit" triggering a duty to pay the "cost of the proceedings involved in the suit" where "suit" was defined as a "civil proceeding that seeks damages." But, a subsequently filed answer to the sanctions petition by the client requesting an award of costs and attorney's fees against the lawyer was held to constitute a "suit" triggering a duty to pay defense costs under the lawyer's professional liability policy. *Id.* at 520–21.

The Superior Court has held that an insurer did not have a duty to defend an insured against criminal proceedings where the duty extended to suits seeking damages. *Patterson v. Reliance Ins. Cos.*, 332 Pa. Super. 592, 481 A.2d 947 (1984). Pennsylvania courts have also refused, on public policy grounds and/or the language of the policy, to require an insurer to defend an insured against civil suits based on criminal acts or intentional torts. *See*, *e.g.*, *Gene's Restaurant, Inc. v. Nationwide Ins. Co.*, 519 Pa. 306, 548 A.2d 246 (1988) (holding no duty owed where underlying complaint alleged assault and battery and occurrence defined in policy as "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured"); *Germantown Ins. Co. v. Martin*, 407 Pa. Super. 326, 595 A.2d 1172 (1990) (holding no duty based on language of the insurance contract and public policy); *Travelers Prop. Cas. Co.*

of Am. v. Mericle, 486 F. App'x 233, 238 (3d Cir. 2012) (applying Pennsylvania law) (holding no duty based on policy's occurrence language and various exclusions, including for knowing violations of rights and violations of penal statutes, and noting Pennsylvania's public policy against shifting responsibility to insurers for one's intentional acts).

When is extrinsic evidence used to determine whether an insurer has a duty to defend?

Generally never, at least at the outset. Pennsylvania strictly follows the "four corners" rule which mandates that the duty to defend be determined solely by comparing the factual averments contained within the four corners of the underlying complaint to the four corners of the insurance contract. *American & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 606 Pa. 584, 609, 2 A.3d 526, 541 (2010); *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 589 Pa. 317, 330, 908 A.2d 888, 896 (2006). Therefore, an insurer typically may not rely upon information outside the allegations of the underlying complaint to determine its duty to defend or deny a duty to defend. *See*, *e.g.*, *Air Prods. & Chems. v. Hartford Accident & Indem. Co.*, 25 F.3d 177, 180 (3d Cir. 1994) (applying Pennsylvania law) (rejecting insurer's attempt use extrinsic evidence to determine whether duty to defend was triggered); *National Fire Ins. Co. v. Robinson Fans Holdings, Inc.*, No. 10-1054, 2011 U.S. Dist. Lexis 77367, at *22–28 (W.D. Pa. July 18, 2011) (same). But, Pennsylvania law provides that the duty to defend can end if the claim is confined to recovery outside the scope of coverage. *Erie Ins. Exch. v. Transamerica Ins. Co.*, 516 Pa. 574, 533 A.2d 1363 (1987); *Charter Oak Fire Ins. Co. v. Sumitomo Marine & Fire Ins. Co.*, 750 F.2d 267 (3d Cir. 1984).

In several limited circumstances, Pennsylvania courts have strayed from this general rule. For instance, in *Heffernan & Co. v. Hartford Ins. Co. of Am.*, 418 Pa. Super. 326, 614 A.2d 295 (1992), the court held that answers to interrogatories filed in the underlying action, which put the insurer on notice that a complaint would probably be amended to state a covered claim, triggered a duty to defend. Similarly, in *Post v. St. Paul Travelers Ins. Co.*, 691 F.3d 500, 518–21 (3d Cir. 2012) (applying Pennsylvania law), the Third Circuit cited *Heffernan* and proceeded to determine if and when a "claim" ("demand that seeks damages") or "suit" ("civil proceeding that seeks damages") was asserted under a professional liability policy that triggered a defense obligation by looking to the circumstances surrounding when the insured was notified of a malpractice claim and a pre-complaint petition for sanctions. Several decisions have permitted an insurer to use extrinsic evidence to show that an exception to an exclusion did not apply. *See*, *e.g.*, *Haines v. State Auto Prop. & Cas. Ins. Co.*, 417 F. App'x 151 (3d Cir. 2011) (applying Pennsylvania law).

In addition, Pennsylvania courts have considered facts and extrinsic evidence outside of the allegations of the underlying complaint, such as deposition transcripts and contracts at issue, in determining a person's status as an "insured" before applying the "four corners" rule to determine whether a duty to defend exists. *See Meridian Mut. Ins. Co. v. Cont'l Bus. Ctr.*, No. 04-1639, 2005 U.S. Dist. Lexis 6406, at *17 (E.D. Pa. Apr. 14, 2005) ("before I can consider whether [the insurer] has a duty to defend the specific claims against [the party], I must determine whether [the party] was insured under [the insurer's] policy at the time of the fire"), *aff'd*, 174 F. App'x 104 (3d Cir. 2006); *Penn Nat'l Ins. v. HNI Corp.*, 482 F. Supp. 2d 568 (M.D. Pa. 2007) (report and recommendation) (looking to deposition transcripts, certificate of insurance and an independent contractor agreement to determine whether a party is an additional insured), *adopted by*, 482 F. Supp. 2d 568 (M.D. Pa. 2007). Extrinsic evidence has also been considered to determine whether the language of a policy exclusion was ambiguous before applying the "four corners" test. *Madison Constr. Co. v. Harleysville Mut. Ins. Co.*, 557 Pa. 595, 606–07, 735 A.2d 100, 106–07 (1999) (permitting insurer to introduce extrinsic evidence about a floor sealant described in the underlying complaint to determine whether it was a "pollutant").

What is the scope of an insurer's duty to defend?

The scope of an insurer's duty to defend is broad. In general, an insurer must defend all claims in a multi-

claim suit so long as at least one claim is potentially covered. *Post v. St. Paul Travelers Ins. Co.*, 691 F.3d 500, 517–18 (3d Cir. 2012) (citations omitted) (applying Pennsylvania law). Thus, where a complaint contains some claims or allegations that are patently not covered, as well as other claims or allegations that might potentially fall within the scope of the policy, the insurer must defend the entire case and must continue to defend until such time as the case is confined exclusively to non-covered claims. *Cadwallader v. New Amsterdam Cas. Co.*, 396 Pa. 582, 590, 152 A.2d 484, 488 (1959); *D'Auria v. Zurich Ins. Co.*, 352 Pa. Super. 231, 234, 507 A.2d 857, 859 (1986). Moreover, "the duty to defend is not limited to meritorious actions; it even extends to actions that are 'groundless, false, or fraudulent' as long as there exists that the possibility that the allegations implicate coverage." *American & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 606 Pa. 584, 610, 2 A.3d 526, 541 (2010) (citations omitted).

It has been held that an insurer has a duty to pay for the insured to assert counterclaims that are "inextricably intertwined" with the defense of the initial claims. *See Post*, 691 F.3d at 521; *TIG Ins. Co. v. Nobel Learning Cmtys., Inc.*, No. 01-4708, 2002 U.S. Dist. Lexis 10870, at *40–41 (E.D. Pa. June 18, 2002); *Safeguard Scientifics, Inc. v. Liberty Mut. Ins. Co.*, 766 F. Supp. 324, 333–34 (E.D. Pa. 1991), *aff'd in part, rev'd in part*, 961 F.2d 209 (3d Cir. 1992). However, an insurer is not required to pay for the cost of the insured asserting a third-party claim. *Post*, 691 F.3d at 522 ("an insurer has a duty to cover an insured's expenses for prosecuting counterclaims in the initial proceeding, but that insurer has no duty to cover the expenses incurred by an insured in prosecuting an entirely new and separate action (even if that action is related to the underlying case)") (adopting rule set forth in *Amquip Corp. v. Admiral Ins. Co.*, 231 F.R.D. 197 (E.D. Pa. 2005)).

Whether an insurer has a duty to take an appeal or pay for the costs of an appeal will turn on the policy language and the facts. For example, some policies disclaim a duty to appeal. *See*, *e.g.*, the policy quoted in *Scottsdale Ins. Co. v. City of Hazleton*, No. 3:07-CV-1704, 2009 U.S. Dist. Lexis 44861 (M.D. Pa. May 28, 2009) ("We will have the right, but no duty, to appeal any judgment."), *aff'd*, 400 F. App'x 626 (3d Cir. 2010). The facts surrounding the decision not to appeal and whether the insurer does or does not pay the judgment may factor in to whether a court determines that the insurer had a duty to appeal. *See*, *e.g.*, *Spears v. Dawson*, 10 Pa. D. & C.3d 703 (C.P. Alleg. Cty. 1979), discussing an insurer's failure to appeal an arbitration award and refusing to pay the judgment due to the insured's failure to cooperate in the context of denying the plaintiff's motion for summary judgment on the insurer's failure to cooperate defense.

When is an insurer responsible for pre-tender defense costs?

Pennsylvania state courts have not specifically addressed this issue. However, federal courts applying Pennsylvania law have held that an insurer is responsible for paying defense costs incurred by the insured before notice of suit was provided to the insurer, unless the insurer can show prejudice by the late notice. *See Dale Corp. v. Cumberland Mut. Fire Ins. Co.*, No. 09-1115, 2010 U.S. Dist. Lexis 65052, at *28–32 (E.D. Pa. June 30, 2010), *vacated on other grounds*, 2010 U.S. Dist. Lexis 127126 (E.D. Pa. Nov. 30, 2010); *Rite Aid Corp. v. Liberty Mut. Fire Ins. Co.*, No. 1:CV-03-1801, 2006 U.S. Dist. Lexis 57094, at *15–19 (M.D. Pa. Aug. 14, 2006); *see also TPLC, Inc. v. United Nat'l Ins. Co.*, 44 F.3d 1484, 1493 (10th Cir. 1995) (applying Pennsylvania law) ("in the absence of a showing of prejudice, the insurer's duty to defend includes the duty to reimburse for reasonable costs of defense incurred prior to notice, as well as for subsequent defense costs").

What is the extent of an insurer's obligation to defend when other insurers also have a duty to defend?

When more than one insurer has a duty to defend the same claim for the same insured, the insurers may make "the selection of the insurer or insurers to undertake a defense," but "[i]n the event that the insurers are unable to agree as to the conduct of the defense, then [the insured] shall be entitled to select an insurer." *J.H. France Refractories Co. v. Allstate*

Ins. Co., 534 Pa. 29, 44, 626 A.2d 502, 510 (1993). In discussing allocation of liability in the context of policies with "all sums" language and its continuous trigger holding based on the etiology of asbestosis, the Supreme Court also noted, "This conclusion does not alter the rules of contribution or the provisions of 'other insurance' clauses in the applicable policies. There is no bar against an insurer obtaining a share of indemnification or defense costs from other insurers under 'other insurance' clauses or under the equitable doctrine of contribution." *Id.* at 42, 626 A.2d at 509. Thus, any allocation with respect to the duty to defend will depend on policy language and the type of claim at issue.

Whether more than one insurer has a duty to defend or indemnify depends on the language of the policies, including the "other insurance" provisions and how they interrelate. In *J.H. France*, the court was dealing with identical language in all policies with respect to the relevant provisions. That is not always the case when multiple policies are at issue. For example, in *Harleysville Ins. Cos. v. Aetna Cas. & Sur. Ins. Co.*, 568 Pa. 255, 795 A.2d 383 (2002), the Pennsylvania Supreme Court addressed the order of priority of two auto policies and an excess policy. The owner of the truck involved in the one-car accident had a primary auto policy and a personal excess liability policy issued by two Harleysville group companies. The Harleysville excess policy had an "other insurance" clause that provided in pertinent part, "The insurance afforded by this policy shall be excess insurance over any valid and collectible primary insurance, whether or not shown in the Declarations." The truck owner permitted his grandson to use the truck and the grandson allowed a friend to drive. The friend's mother had an auto policy issued by Aetna that had an "other insurance" clause providing that "any insurance we provide for a vehicle you do not own shall be excess over any other collectible insurance." Aetna refused to defend the suit by the grandson against the friend on the basis that its policy was excess to all other insurance. Harleysville defended, settled the case for an amount paid by the owner's primary policy and the owner's excess policy, reserving rights against Aetna. In the declaratory judgment action, Harleysville argued that its excess policy, as a true excess, should be above the Aetna policy or the two should share defense and indemnity equally due to both being excess. The court held that because the Harleysville other insurance clause provided that the policy was only excess to "primary insurance" and the Aetna "other insurance" clause provided that it was excess over any collectible insurance, the Aetna auto policy was excess to the Harleysville excess policy because the Aetna policy was not "primary insurance" under the circumstances. *But see White v. Cont'l Ins. Co.*, 233 F. App'x 135 (3d Cir. 2007) (holding driver's auto policy occupied the first tier excess layer and the owner's excess coverage occupied the second tier excess layer, distinguishing *Harleysville* based on the wording of the at-issue "other insurance" clauses); *American States Ins. Co. v. Maryland Cas. Co.*, 427 Pa. Super. 170, 628 A.2d 880 (1993) (holding primary policy and umbrella policy both had a duty to defend and thus umbrella insurer who refused to defend could not prevail on a bad faith claim against the primary insurer after entry in the underlying action of a judgment in excess of the primary limits).

When is there a right to independent counsel?

An insurer that undertakes a duty to defend generally has the right to defend the litigation and select counsel of its choice. *Widener Univ. v. Fred S. James & Co.*, 317 Pa. Super. 79, 87 n.9, 537 A.2d 829, 833 n.9 (1988); *Eckman v. Erie Ins. Exch.*, 2011 PA Super 87, 21 A.3d 1203, 1207 (2011). However, an insured has the right to independent counsel of its choosing when an actual conflict of interest between the insured and insurer, rather than a theoretical or potential conflict of interest, is found to exist, with the insurer having the right to reject an unreasonable selection. *See Maddox v. St. Paul Fire & Marine Ins. Co.*, No. 01-1264, 2002 U.S. Dist. Lexis 26686, *appeal dismissed*, 70 F. App'x 77 (3d Cir. 2003); *St. Paul Fire & Marine Ins. Co. v. Roach Bros. Co.*, 639 F. Supp. 134, 139 (E.D. Pa. 1986).

What constitutes an actual conflict of interest has not been clearly defined by Pennsylvania appellate courts, but several decisions have weighed in on the issue. For instance, it is not a conflict of interest for

the insurer to "control the defense" of the insured while also reserving its rights to later contest a duty to indemnify. *See*, *e.g.*, *Eckman*, 21 A.3d at 1208–09; *Babcock & Wilcox Co. v. Am. Nuclear Insurers*, 2013 PA Super 174, 76 A.3d 1, 13 (2013), *rev'd on other grounds by*, No. 2 WAP 2014, 2015 Pa. Lexis 1551 (Pa. July 21, 2015); *Charter Oak Ins. Co. v. Maglio Fresh Food*, 979 F. Supp. 2d 581, 597–98 (E.D. Pa. 2013). Therefore, the mere fact that an insurer defends under a reservation of rights does not require the insurer to pay for counsel selected by the insurer. *See*, *e.g.*, *Eckman*, 21 A.3d at 1207. Courts have also held that the fact that defense counsel retained by the insurer engaged in aggressive tactics to seek dismissal of a covered claim, without evidence that the attorney was acting for the benefit of the insurer, did not establish a conflict of interest requiring the insurer to pay for independent counsel of the insured's choosing. *Scottsdale Ins. Co. v. City of Hazelton*, No. 3:07-CV-1704, 2009 U.S. Dist. Lexis 44861, *33–37 (M.D. Pa. May 28, 2009), *aff'd*, 400 F. App'x 626 (3d Cir. 2010). The potential for liability to the insurer in an amount in excess of policy limits also does not create an actual conflict of interest, as both the insurer and insured have the same interests in preventing a finding of liability or, alternatively, minimizing damages. *Roach Bros. Co.*, 639 F. Supp. at 139; *Pennbank v. St. Paul Fire & Marine Ins. Co.*, 669 F. Supp. 122, 126–27 (W.D. Pa. 1987).

A state trial court has held that "[a]ctual proof that attorneys have disregarded their ethical duties to their clients as set forth in the professional rules of conduct is necessary to establish the conflict of interest." *Yaron v. Darwin Nat'l Ins. Co.*, No. 502, Commerce Program, 2011 Phila. Ct. Com. Pl. Lexis 167, at *12 (C.P. Phila. Cty. July 5, 2011). Another decision has stated that "[a] conflict of interest arises between an insured and insurer when the company's pursuit of its own interests in the litigation is incompatible with the best interests of the insured." *Kvaerner U.S., Inc. v. One Beacon Ins. Co.*, 74 Pa. D. & C. 4th 32 (C.P. Phila. Cty. 2005) (citation omitted).

Pennsylvania courts have not squarely addressed what constitutes "independent counsel." Several decisions have suggested that it means counsel selected by the insured and paid for by the insurer. *Scottsdale*, 2009 U.S. Dist. Lexis 44861 at *34 (noting that where a conflict of interest exists, "the insured is entitled to choose its counsel, whose reasonable fee must be paid by the insurer"); *Kvaerner U.S., Inc.*, 74 Pa. D. & C. 4th 32 (noting an appropriate resolution to an actual conflict of interest "is for the insurer to obtain separate, independent counsel for its insured, or to pay the costs incurred by an insured in hiring counsel"). In addition, while not directly addressed by Pennsylvania state courts, a federal court has predicted that Pennsylvania courts would "hold that when an insurer is required to hire independent counsel, whether due to a prior improper refusal to defend or an actual conflict, that insurer still retains the right to veto plaintiff's counsel selection with good reason" even though the insurer cannot require the insured to accept panel counsel as "independent counsel." *Maddox*, 2002 U.S. Dist. Lexis 26686 at *10, *12–13. The insurer may also require that the rates and fees charged by independent counsel be reasonable and necessary. *See Yaron*, 2011 Phila. Ct. Com. Pl. Lexis 167 at *7 ("An insurer's duty to defend includes providing competent counsel and paying the reasonable, necessary costs of the representation.") (citing *Scottsdale Ins. Co.*, *supra*).

What right of recoupment of defense costs exists for an insurer?

Absent policy language or a separate agreement specifically stating otherwise, an insurer has no right to recoup defense costs it paid to defend its insured even if it is later determined that the insurer did not owe a duty to defend. *American & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 606 Pa. 584, 614–18, 2 A.3d 526, 544–46 (2010). Attempts by insurers to seek recoupment of defense costs based on a theory of unjust enrichment or a theory that a reservation of rights letter created an implied contract have been explicitly rejected. *Jerry's Sport Ctr., Inc.*, 606 Pa. at 616–17, 2 A.3d at 545; *Utica Mut. Ins. Co. v. Rohm and Haas Co.*, 683 F. Supp. 2d 368, 374–76 (E.D. Pa. 2010). Recoupment of defense costs has been permitted where expressly provided for in the insurance contract. *Camico Mut. Ins. Co. v. Heffler, Radetich & Saitta L.L.P.*, 587 F. App'x 726, 731 (3d Cir. 2014) (applying Pennsylvania law).

What are the consequences of an insurer's wrongful failure to defend?

"An insurance company's refusal to defend at the outset of the controversy is a decision it makes at its own peril." *Cadwallader v. New Amsterdam Cas. Co.*, 396 Pa. 582, 589, 152 A.2d 484, 488 (1959); *Pittsburgh Bd. of Educ. v. Nat'l Union Fire Ins. Co.*, 709 A.2d 910, 913 (Pa. Super. Ct. 1998), *appeal denied*, 556 Pa. 669, 727 A.2d 126 (1998). Where an insurer wrongfully fails or refuses to defend, it is liable for reimbursing the insured for the fees and costs it incurred in handling its own defense. *See*, *e.g.*, *Kelmo Enters., Inc. v. Commercial Union Ins. Co.*, 285 Pa. Super. 13, 426 A.2d 680 (1981); *St. Paul Fire & Marine Ins. Co. v. Roach Bros. Co.*, 639 F. Supp. 134, 138–39 (E.D. Pa. 1986). Additionally, the insurer may be required to pay fees and costs the insured incurred in a declaratory judgment action filed by the insured against the insurer if the insurer is found to have denied a defense in bad faith. *Kelmo Enters.*, 285 Pa. Super. at 24, 426 A.2d at 685; *First Pennsylvania Bank, N.A. v. Nat'l Union Fire Ins. Co.*, 397 Pa. Super. 612, 621, 580 A.2d 799, 803 (1990).

An insurer that wrongfully fails or refuses to defend may also be exposed to an action pursuant to the Pennsylvania bad faith statute, 42 Pa. Cons. Stat. §8371. That statute provides that if the court finds that the insurer acted in bad faith towards the insured, the court may take the following actions:

> (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
>
> (2) Award punitive damages against the insurer.
>
> (3) Assess court costs and attorney fees against the insurer.

42 Pa. Cons. Stat. §8371. Pennsylvania also recognizes a common law bad faith action for breach of the implied contractual duty of good faith, which may be brought as a breach of contract claim. *Cowden v. Aetna Cas. & Sur. Co.*, 389 Pa. 459, 476, 134 A.2d 223, 231 (1957); *Birth Ctr. v. St. Paul. Cos.*, 567 Pa. 386, 787 A.2d 376 (2001). A breach of the implied contractual duty of good faith may subject an insurer to known and foreseeable compensatory damages resulting from the breach, which may include damages in excess of policy limits and lost profits and lost business opportunities by the insured. *Birth Ctr.*, 567 Pa. at 407, 787 A.2d at 389.

An insurer that has wrongfully failed to defend is not automatically required to indemnify the insured for a settlement. *American States Ins. Co. v. State Auto Ins. Co.*, 721 A.2d 56, 64 (Pa. Super. Ct. 1998) ("we will not adopt a blanket rule that if there is a breach of a duty to defend and a settlement, then it automatically requires the breaching insurer to indemnify"). This is consistent with the principle that waiver and estoppel are "not available to bring within the coverage of an insurance policy, risks that are expressly excluded therefrom." *Pfeiffer v. Grocers Mut. Ins. Co.*, 251 Pa. Super. 1, 6, 379 A.2d 118, 121 (1977). However, estoppel may preclude an insurer from denying a duty to indemnify where the insurer wrongfully withdraws its defense without previously reserving its rights to deny coverage and justifiable reliance and actual prejudice to the insured are proven. *Beckwith Machinery Co. v. Travelers Indem. Co.*, 638 F. Supp. 1179, 1188–89 (W.D. Pa. 1986) (holding insurer was estopped from denying duty to indemnify for settlement where insurer wrongfully withdrew its defense after defending for thirteen months without any reservation of rights), *appeal dismissed*, 815 F.2d 286 (3d Cir. 1987); *Merchants Mut. Ins. Co. v. Artis*, 907 F. Supp. 886 (E.D. Pa. 1995) (actual prejudice due to withdrawal of defense must be shown in order to estop insurer from later denying coverage).

What terminates an insurer's duty to defend?

Once an insurer undertakes a defense, it must continue to defend unless and "until the claim is narrowed to one patently outside the policy's coverage." *Stidham v. Millvale Sportsmen's Club*, 421 Pa. Super. 548, 564, 618 A.2d 945, 954 (1992), *appeal denied*, 536 Pa. 630, 637 A.2d 290 (1993); *see also Erie Ins. Exch. v. Transamerica Ins. Co.*, 516 Pa. 574, 583, 533 A.2d 1363, 1368 (1987) ("it is the duty of the insurer to defend until such time as the claim is confined to a recovery that the policy does not cover.") (citation omitted). Therefore, a duty to defend terminates "if

the cause of action upon which the duty to defend exists is dismissed." *Meridian Mut. Ins. Co. v. James Gilligan Builders*, No. 08-1995, 2008 U.S. Dist. Lexis 109018, at *2 (E.D. Pa. June 18, 2009). An insurer's duty to defend also typically terminates where an insurer exhausts its policy limits by paying a judgment or settlement that releases its insured. *See Maguire v. Ohio Cas. Ins. Co.*, 412 Pa. Super. 59, 67, 602 A.2d 893, 896 (1992), *appeal denied*, 532 Pa. 656, 615 A.2d 1312 (1992); *Commercial Union Ins. Co. v. Pittsburgh Corning Corp.*, 789 F.2d 214 (3d Cir. 1986) (applying Pennsylvania law); *but see Liberty Mut. Ins. Co. v. Pacific Indem. Co.*, 557 F. Supp. 986 (W.D. Pa. 1983) (requiring insurer to defend even though limits were exhausted where policy did not "make the insurer's duty to defend dependent on the policy's liability limitations."), *aff'd on rehearing*, 579 F. Supp. 140 (W.D. Pa. 1984). "The principle that the duty to defend is linked to the duty to indemnify, and consequently that, absent other considerations, the insurer is not bound to defend where it cannot be bound to indemnify, applies regardless of when the duty to indemnify comes to an end." *Pittsburgh Corning*, 789 F.2d at 218. However, an insurer may not extinguish its duty to defend by attempting to pay its policy limits into court where doing so would not end the lawsuit against the insured. *Maguire*, 412 Pa. Super. at 65–67, 602 A.2d at 896; *Simmons v. Jeffords*, 260 F. Supp. 641, 642 (E.D. Pa. 1996).

If the insurer's duty to defend terminates, the insurer may withdraw its defense even if the underlying action is still ongoing so long as it "do[es] so in an orderly manner that will not prejudice the insured." *State Farm Fire & Cas. Co. v. Cooper*, No. 00-5538, 2001 U.S. Dist. Lexis 17050, *17–18 (E.D. Pa. Oct. 24, 2001). An insurer is not required to file a declaratory judgment action in order to withdraw its defense of the insured. But, it may be prudent for an insurer to file a declaratory judgment action to determine its duty to defend when a dispute arises. *Terra Nova Ins. Co. v. 900 Bar, Inc.*, 887 F.2d 1213, 1219–21 (3d Cir. 1989) (applying Pennsylvania law). Indeed, Pennsylvania courts have recognized that it is "common practice" for an insurer to defend under a reservation of rights and simultaneously file a declaratory judgment to determine whether it has a duty to defend. *Step Plan Servs., Inc. v. Koresko*, 2010 PA Super 232, 12 A.3d 401, 419 (2010).

If there is no duty to defend, can the insurer have a duty to indemnify?

No, under a policy containing a duty to defend provision. If the insurer "does not have a duty to defend [the insured] … neither does it have the duty to indemnify." *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 589 Pa. 317, 330 n.7, 908 A.2d 888, 896 n.7 (2006). The duty to defend, which arises when the underlying complaint alleges liability *potentially* within the policy's coverage, is broader than the duty to indemnify because the *potential* liability may never give rise to *actual* liability. *General Accident Ins. Co. of Am. v. Allen*, 547 Pa. 693, 706, 692 A.2d 1089, 1095 (1997). Consequently, if there is no duty to defend it naturally follows that there is no duty to indemnify. *Scopel v. Donegal Mut. Ins. Co.*, 698 A.2d 602, 605 (Pa. Super. Ct. 1997); *Sikirica v. Nationwide Ins. Co.*, 416 F.3d 214, 225 (3d Cir. 2005). Keep in mind that some policies only agree to indemnify and not to defend. *See*, *e.g.*, *AstenJohnson, Inc. v. Columbia Cas. Co.*, 562 F.3d 213 (3d Cir. 2009) (noting duty to defend depends on whether contract provides for such a duty and enforcing provision that disclaimed duty to defend in excess policy).

Are there any other notable cases or issues regarding the duty to defend that are important to the law of this jurisdiction?

In *Babcock & Wilcox Co. v. Am. Nuclear Insurers*, No. 2 WAP 2014, 2015 Pa. Lexis 1551 (Pa. July 21, 2015), the Supreme Court of Pennsylvania held that an insured is entitled to coverage from its insurer when it settles a lawsuit without its insurer's consent where the insurer defends the insured subject to a reservation of rights, so long as the insured demonstrates that the claim is covered under the policy and the settlement was fair, reasonable, and non-collusive. The court rejected the insurer's contention that the insured must prove the higher burden of bad faith by the insurer in order to be entitled to coverage for a

settlement made without the insurer's consent under the specific circumstances addressed by the court, and noted that all reservations of rights are not equal.

For a case dealing with the timing of when an excess policy's duty to defend begins, *see Lexington Ins. Co. v. Charter Oak Fire Ins. Co.*, 2013 PA Super 286, 81 A.3d 903 (2013), wherein the Superior Court gave effect to the policy language and held that the excess insurer's duty to defend did not arise until the underlying insurer had actually paid its limits rather than two months earlier when the underlying insurer had reached settlements that would result in exhaustion of its policy limits upon payment.

As with all matters, whether an insurer will owe a duty to defend one claiming to be an additional insured will depend on the policy language and the underlying complaint, and, depending on the language of the insurance policy, it might also depend on the terms of the contract between the named insured and the additional insured. Cases dealing with the duty to defend an alleged additional insured include the following: *Mutual Benefit Ins. Co. v. Politsopoulos*, No. 60 MAP 2014, 2015 Pa. Lexis 1126 (Pa. May 26, 2015); *Township of Springfield v. Ersek*, 660 A.2d 672 (Pa. Commw. Ct. 1995), *appeal denied*, 544 Pa. 640, 675 A.2d 1254 (1996); *Selective Ins. Co. of S.C. v. Lower Providence Twp.*, No. 12-0800, 2013 U.S. Dist. Lexis 89592 (E.D. Pa. June 26, 2013); *Philadelphia Elec. Co. v. Nationwide Mut. Ins. Co.*, 721 F. Supp. 740 (E.D. Pa. 1989); *Harbor Ins. Co. v. Lewis*, 562 F. Supp. 800 (E.D. Pa. 1983).

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