PECULIARITIES OF LOUISIANA LAW AFFECTING INSURERS

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SUTTERFIELD & WEBB, L.L.C.

Suite 2715
Poydras Center
650 Poydras Street
New Orleans, LA 70130-6121
Tel: (504) 598-2715
Fax: (504) 529-7197
E-Mail: info@swslaw.com

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by

James R. Sutterfield[1]

This paper will address, in no particular order, some of the peculiarities of Louisiana law as they affect insurers providing coverage in that state whether on an admitted or surplus lines basis.

DUTY TO DEFEND

As a general rule, where a policy provides for defense, an insurer's duty to defend suits brought against its named assured is determined by the allegations of the plaintiff's petition, unless the petition unambiguously excludes coverage. In other words, insurers are bound to defend assureds on the merits of the claim if any portion of the claim falls under the policy. However, the duty to defend is not absolute. If the allegations bring the claim clearly within an exclusion or outside the coverage of the policy, there will be no duty to defend.

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*[1] Senior Director of **Sutterfield & Webb, LLC**, practicing in Louisiana and Texas with emphasis on insurance/reinsurance, maritime law, product liability and professional liability. He is admitted to practice in the state and federal courts of Louisiana, Texas and the District of Columbia, and The Supreme Court of the United States. He formerly served as Chairman of the American Bar Association's Excess, Surplus Lines & Reinsurance Committee. As a member of the International Association of Defense Counsel, Mr. Sutterfield chaired the Maritime and Energy Law Committee and the Committee on Class Actions and Multi-Party Litigation. He is also an active member of the Maritime Law Association of the U.S., Association Internationale de Droit des Assurances, The Defense Research Institute, The Louisiana Association of Defense Counsel and the New Orleans Bar Association. He serves as an expert witness in insurance and reinsurance cases and is the author of a number of articles on maritime and insurance law and a chapter on liability insurance for the Mathew Bender set, Commercial Damages. Mr. Sutterfield completed his undergraduate studies at Tulane University and The University of Texas, received a J.D. degree from Loyola University and was awarded a Masters of Law degree in Admiralty, with distinction, by Tulane University. He was admitted to the bar in 1967.*

WAIVER AND ESTOPPEL

Louisiana courts recognize an insurer's right to deny coverage and yet furnish its assured with a defense on the merits without subjecting itself to liability. Accordingly, it has been held that the doctrine of waiver or estoppel cannot be invoked in Louisiana to bring within the coverage of an insurance policy those risks not included nor contemplated by its terms. If a certain risk is excluded, then coverage for such circumstance should not be afforded merely because the insurer assumed the defense of the assured prior to a determination of coverage issues.

Louisiana courts have additionally held that an insurer's actions in paying part of the claim does not constitute an admission of coverage which will estop the insurer from denying coverage for further payment. This is particularly important in a multiple claim occurrence where smaller claims are settled quickly for commercial reasons.

On the other hand, in a recent Louisiana Supreme Court decision, "Steptore" (Steptore vs. Masco Construction Co.) a matter involving a violation of a warranty, it was held that the insurer waived its right to assert the violation of the warranty as a coverage defense where it had assumed and continued the defense of its assured in the face of facts indicating it had the right to deny coverage.

NON-WAIVER AGREEMENTS IN GENERAL

The execution of a non-waiver agreement (reservation of rights letter), whereby the insurer agrees to defend and the assured recognizes the right of the insurance company to question coverage, is the standard method in most

jurisdictions for an insurer to avoid a waiver of rights.

Where, as in Louisiana, an action by an assured party may be directed jointly against insurer and assured, an insurer must be wary of the possibility of conflicts of interest when he chooses to reserve his rights in reference to coverage through the use of a non-waiver agreement. Should an insurer issue a reservation of rights letter, an assured under certain circumstances may be able to assert that he has a right to separate counsel to defend him on a potentially non-covered claim. This arises because the insurer's duty to defend is broader than its duty to indemnify. For example, when the plaintiff's complaint urges alternative claims, only one of which would be covered under the policy, an insurer has an interest to argue that the facts of the case establish that the claim was not covered.

A Louisiana appellate court has ruled that whenever an insurer chooses to represent the assured but deny coverage upon the claim as a whole, predicated not upon the allegations of the petition but upon the insurer's conclusions that no coverage exists, it must employ separate counsel to represent the assured in defense of the plaintiff's claim. The insurer has no obligation to pay the assured's attorney fees incurred with respect to a coverage issue.

RESERVATION OF RIGHTS LETTER

Although traditionally Louisiana law had not established a requirement that an insurer reserve its rights in order to deny coverage in the future, several Louisiana appellate courts, including the Supreme Court, have now brought Louisiana more in line with other jurisdictions on this point. Recent cases have

cited the Texas case of Ideal Mutual Ins. Co. v. Myers which offers an excellent blueprint for the preparation of an effective reservation of rights letter. In the decision, the Court stated that an appropriate and adequate reservation of rights letter will include the following:

1. *The letter will specifically identify the policy in question;*
2. *It will inform the assured that it has appointed counsel to defend the claim;*
3. *It will apprise the assured of the initial results of the insurer's investigation; and*
4. *It will apprise the assured of the insurer's reservation of rights under the policy, including the right to withdraw from the defense if applicable.*

The reservation of rights letter in Myers went even further and advised the assured that it was at liberty to secure counsel of its own choice, at its expense, to represent it in regard to the amount sued for which was in excess of the limits of coverage. Further, it advised the assured that there could be a conflict of interest between the insurer and the assured in that if negligence of the insurer should cause a judgment to be rendered against the assured in excess of the insurance limits, the insurer might ultimately be held responsible for the excess judgment.

SUITS ALLEGING PUNITIVE DAMAGES

The standard rule in the United States is that unless prohibited by public policy, an insurance policy covering "all sums which the assured shall be obligated to pay by reason of the liability imposed by law" without any specific exclusion for punitive damages will generally be held to cover and require the insurer to pay the

punitive damage loss as a matter of policy interpretation.

Until 1984, Louisiana state law did not allow recovery of punitive damages, and accordingly public policy arguments for and against coverage were not well developed. Federal courts in three late 1980's cases applying Louisiana law addressed public policy considerations, all with results in favor of the insurers. In these cases the Court held that punitive damages were to punish and to deter. If a defendant could insure those risks, there would be no punishment and deterrence as the costs would be spread over the entire premium paying public.

These cases also suggested that punitive damages were akin to intentional actions and, hence, not accidental.

*At the time they were rendered, these decisions appeared to preclude the insuring of punitive damage exposure in Louisiana, but in 1988, Louisiana courts took a different view. In **Creech v. Aetna Casualty & Surety Co.**, the court held that the Insuring Agreement language of the standard automobile policy (which incidentally is identical to the Insuring Agreement language of the standard CGL policy L.6394) compels coverage for punitive damages unless otherwise excluded. The court rejected public policy arguments, stating "permitting insurance coverage for such acts will not likely increase the frequency of such acts any more than permitting insurance coverage for ordinary negligent acts increases their frequency." The insurability of punitive damages is now pretty well settled in Louisiana law and a Louisiana court will hold that punitive damages are insurable and are covered in a standard CGL policy unless specifically excluded. It should be noted that at the present time, Louisiana law allows an award of punitive*

damages in a tort context only in two instances:

1. *Where the intoxication of a motor vehicle operator was a cause in fact of the resulting injuries;*

2. *Where the conduct involved criminal sexual activity with a minor. Our courts have held that criminal sexual activity with a minor is, as a matter of law, intentional and thus not insurable for either compensatory or punitive damages. By its own terms, this provision is applicable only to the perpetrator.*

Until 1996, punitive damages were also available where wanton and reckless disregard for public safety in the storage, handling or transportation of hazardous or toxic substances caused injury, but the provision has now been repealed.

DUTY TO DEFEND PUNITIVE DAMAGE CLAIMS

In Louisiana, it is well settled that the allegations of fact, rather than conclusions, contained in the petition or complaint determine the obligation to defend. Naming the insurer as a defendant under the Direct Action Statute and alleging that it issued a policy providing coverage for the assured's liability is not sufficient. The factual allegations must state a claim which is covered under a policy issued by the insurer. Accordingly, where punitive damages are excluded, insurers have no obligation to defend claims for punitive damages where that claim can be separated from the portion of the claim that is covered. This has generally been handled by informing the assured of this and giving the assured the opportunity to retain, at its own expense, counsel to associate with counsel provided by the insurer, with the assurance of full cooperation by the insurer and

its counsel. Where the claims for compensatory damages and non-covered punitive damage cannot be separated, the insurer must defend the whole suit.

ENDORSEMENTS OVERRIDE POLICY TERMS

A common practice when writing comprehensive general liability coverage is to use certain standard forms of basic coverage and then modify the policy by the use of certain other endorsements.

In Louisiana, an endorsement becomes part of the insurance policy and the endorsement and the policy become parts of the same contract and must be construed together. It has been held that in the event of a conflict between the endorsement and the policy, the endorsement prevails.

Often the introductory language of an exclusionary endorsement will clearly provide that it will apply "notwithstanding anything to the contrary contained in the policy." This has been interpreted to mean that the obvious intent of the endorsement is that in respect of any conflict between the provisions of the endorsement and the policy itself, the provisions of the endorsement will control.

THE LOUISIANA DIRECT ACTION STATUTE

In most jurisdictions, a party claiming to have been injured by an insured may not sue the insurer until having obtained a judgment against the insured or if the insured is bankrupt, having received permission from the Bankruptcy Court. This rule, however, has met with change in several of the United States and Puerto Rico through the enactment of a "direct action statute," which vests the injured party with a direct cause of action against the insurer. In such states, the injured party may join the tortfeasor's insurer as an additional defendant in any action

filed against the tortfeasor, or in some cases, may even bring suit solely against the insurer. It is even possible in some States, such as Louisiana, for an injured party to enter into a settlement with the insured and still preserve his or her rights against the insurer if the settlement agreement expressly so provides. Finally, because some defenses are considered "personal" to a potential defendant, at times an injured party may maintain an action against a tortfeasor's insurer when the tortfeasor could not himself sue his own insurer, such as claims proscribed by interspousal immunity.

Although several states and the Territory of Puerto Rico have enacted direct action statutes, the best known and most well developed is that of the State of Louisiana, which enacted its direct action statute in 1918. Since that time, the Act has been amended various times (see current law attached) so that a direct action may be maintained against an insurer in a claim sounding in tort (for personal injury, death or property damage) when either the policy of insurance sued upon was written or delivered in State of Louisiana or the accident or injury occurred within the State of Louisiana. The Legislature has further expressed the intent that all liability policies "within their terms and limits" are executed for the benefit of all injured persons to whom the insured is liable, and that the purpose of such policy is to give protection and coverage to all insureds whether they are named insured or additional insureds under the omnibus clause for any legal liability said insured "may have as or for a tortfeasor within the terms and limits of said policy." Finally, the Louisiana Supreme Court has held that the Direct Action Statute applies to any insurance against the liability of the insured for the personal

injury or corporeal property damage to a tort victim, regardless of whether the policy is framed in liability or indemnity terms. The courts have, however, refused to extend the Direct Action Statute to allow a direct action against a reinsurer where the contract of reinsurance does not include a "cut through" provision.

As can be imagined, the Direct Action Statute causes unique problems for insurers.

The initial difficulty to insurers in general is that an action coupling both the insured and the insurer as defendants creates the potential for counsel assigned to defend the insured to be placed in a conflict of interest proscribed by legal ethics. As a result, it may be necessary for the insurer to engage separate counsel for itself and the insured thereby increasing the cost of defense. Even where there is no apparent conflict nor the appearance of any disagreement on the coverage provided, such that one lawyer can ethically represent both, great care must be taken to ensure that there is not even a hint that the lawyer's foremost responsibility is to anyone but the insured. If the amount of policy limits is germane to settlement, defense counsel may have a conflict requiring separate counsel for the insurer. If a part of the claim is covered and a part not, the same situation arises.

While a direct action statute impacts all insurers providing potential coverage for third party claims, it particularly impacts insurers providing coverage on what is intended to be an indemnity basis.

The Direct Action Statute was first applied to a policy of indemnity insurance

by the United States Fifth Court of Appeals in 1952 in the case of Cushing v. Maryland Casualty Company, later affirmed by the United States Supreme Court. The Fifth Circuit overruled the district judge who had ruled that the Direct Action Statute did not apply to P&I insurance written on an indemnity basis and stated that in enacting the Direct Action Statute:

> *"The Louisiana Legislature used the term "liability insurance in its broad generic sense, meaning that form of insurance by which an insured is indemnified against liability on account of bodily injury sustained by others..."*

The Louisiana Direct Action Statute becomes a part of every insurance contract having effect in Louisiana as though it was written into each policy. Humble Oil & Refinery Co. v. M/V JOHN E COON, 207 F.Supp. 45 (1962). It therefore becomes a condition of the policy that the insurer confers upon an injured party the right to maintain an action directly against the insurer. Agreements between the insured and insurer in respect of deductibles, etc. cannot bind the tortfeasor. Accordingly, the insurer can be liable up to the full amount of its policy whether or not it can obtain the deductible from the insured. On the other hand, a self-insured retention, unlike a deductible, is simply a recognition of non-coverage for a certain portion of the claim. In that case, the insurer would not have to pay the insured's self-insured retention.

One other difficulty brought about by the Direct Action Statute is the damage it does to policy provisions requiring arbitration of coverage disputes. While obviously such provisions are enforceable as between the insurer and its insured, it was held in the Matter Of Talbot Bigfoot, Inc., a 1989 Fifth Circuit case,

that such policy provisions requiring arbitration of coverage disputes between the insured and the insurer would not prevent a direct action by the claimant against the insurer. Accordingly, the arbitration clause can become moot in this instance.

The Louisiana Direct Action statute only applies to tort claims. Often, in litigation involving multiple defendants, one will sue another for indemnity and also name that party's insurer on the basis that the insurer has provided contractual indemnity coverage to the party. The direct action statute does not allow this claim against the insurer as it sounds in contract rather than tort, and a motion to strike the claim should be filed by the insurer.

Are there any favorable aspects to a direct action statute for an insurers? In some situations involving questions of coverage, a direct action can be a blessing. The insurer does not have to await the outcome of the litigation he is paying to defend in order to deny coverage for all or a part of the claim. The courts have recently shown an increasing reluctance to allow declaratory judgment actions on coverage to run parallel with the underlying action fearing damage to the insured's ability to defend the underlying claim. The trend now is to issue a stay of such action pending completion of the underlying case. This can be devastating because, as a practicality, valid coverage defenses may be lost as a result of commercial decisions to settle. In a direct action, the insurer's counsel (separate from counsel assigned to represent the insured) may contest coverage in the same proceeding through summary judgment efforts and, if completely successful, the insurer's duty to defend may be extinguished prior to protracted

and expensive litigation.