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Insurance Coverage for Municipalities and Municipal Officials

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I. Introduction

Cities and towns were once insulated from liability by the doctrine of sovereign immunity. States and their political subdivisions remained immune from suit unless (and to the extent) they expressly waived such immunity. Prompted, however, by the continued injustice of requiring citizens to bear the costs of injuries inflicted by wrongful governmental activities, sovereign immunity has, in most jurisdictions, been abrogated by judicial decree, statutory reform or constitutional amendment, at least in certain circumstances. In Monell v. New York City Dep't of Social Services, 436 U.S. 658 (1978) the United States Supreme Court held that a municipality qualifies as a "person" within the meaning of 42 U.S.C. § 1983 and, therefore, can be sued and held liable for civil rights violations resulting from an unconstitutional policy or practice.

Today, municipalities and municipal officials face exposure to third parties under state and federal remedies in a wide variety of areas – ranging from injuries suffered in accidents on public property, to employees victimized by unlawful harassment, discrimination or retaliation, to individuals deprived of their civil rights by government and government officials acting under color of state law. Given such exposures and the inability of most municipalities to operate without adequate protection from civil liability, the importance of a well-designed insurance plan is essential. Even with such a plan in place, municipalities and municipal officials should be aware of their rights and duties under the policies issued.

II. Types of Insurance

The multitude of municipal policies available reflects the variety of risks to which cities and towns are exposed. Ordinarily, there is little overlap between policies, as each insurance contract is crafted (to the extent possible) to avoid or exclude risks better insured other contracts. The following list of policies is not exhaustive.

A. Property

Property insurance protects the real and personal property of a municipality against damage or loss due to covered risks. Even small municipalities own, rent or control many facilities that would be prohibitively expensive for a community to repair or replace in the event of a catastrophic loss. Thus, it is important that all public facilities and their contents – town halls, schools, public libraries, fire stations, police stations, garages, senior centers, community centers, field houses, treatment plants, etc. – be protected from damage or loss by property insurance. Issues that frequently arise with regard to property insurance include:

- Was the damaged property covered under the policy? For example, are computer data, records and other documents, the personal effects

of others, or accounts receivable, considered covered property?

- Was the damage or loss caused by a covered peril? Municipal properties face numerous risks of loss due to a variety of perils, including, but not limited to, fire, smoke, floods, storms, weight of ice and snow, earthquakes, lightning, sewer backups, theft, vandalism, terrorism and explosion.

- To what extent is municipal property covered? In the event of a loss, will the insurer pay full replacement cost or only the actual cash value (ACV) of the lost property, defined as replacement cost minus depreciation?

- What are the policy limits? Are the limits adequate to protect the municipality in the event of a covered loss? How much is the policy deductible? Although a school building may be adequately insured, it is important that all personal property within the school – *e.g.*, desks, furniture, books, cabinets, appliances, computers and electronics, school records, etc. – also be covered.

B. Automobile

Municipal vehicles – *e.g.*, police cruisers, fire engines, ambulances, snow plows, public works trucks, tow trucks, school buses and vans – must not only be insured against damage or loss due to an accident or collision, but must also carry insurance to protect the municipality from liability for bodily injury or property damage caused to others by municipal officials or employees operating such vehicles within the scope of their employment. In most jurisdictions, an automobile policy or liability bond issued to cover a vehicle registered in that state is required to carry certain coverages with mandatory minimum limits. Also, because a municipality faces automobile liability exposure when a municipal official is driving his or her own vehicle on government business, it is important that an automobile policy protect against this risk as well. Issues that may arise under an automobile policy include:

- What vehicles are covered or "listed" under the policy?

- Was the operator of the vehicle a municipal employee or a permissive user?

- To what extent is the equipment in the vehicle – *e.g.*, firefighting, medical, electronics – also covered?

- Was the operator of the municipal vehicle acting within the scope of his or her employment at the time of the accident? This may affect the immunity of both the operator and the municipality.

- If the municipal official was operating his or her own vehicle on municipal business at the time of the accident, does the municipality qualify as a permissive user and, therefore, an additional insured under the operator's personal automobile policy?

C. General Liability

General liability insurance, typically provided under a Comprehensive (or Commercial) General Liability policy (CGL), affords a municipality with a variety of protections against a great many liability risks. (See sample CGL form attached). Such coverages typically include protection against claims for damages brought by third persons alleging bodily injury or property (Coverage A), claims for damages brought by third persons alleging personal injury and advertising injury (Coverage B), and medical payments to persons injured while on municipal premises as a result of an accident (Coverage C). As set forth in the CGL policy, each coverage is subject to its own definitions and exclusions. Risks typically insured under a general liability policy include:

- Claims arising out of the physical condition of schools and other municipal buildings, parking lots, ball fields, stadiums, stands, benches, playgrounds, parks, beaches, piers, golf courses, etc.

- Claims arising out of hazards or defects in public ways and sidewalks – *e.g.*, potholes, missing guardrails, missing signs, defective traffic signals, poor lighting, excavations, road work or construction;

- Sewer backups, water main breaks and power outages;

- Claims arising out of supervised field trips and tours;

- Claims arising out of athletic practices, competitions and events;

- Claims arising out of fairs, parades, concerts and fireworks displays;

- Claims of negligent security; and

- Certain enumerated torts, such as false arrest, false imprisonment, malicious prosecution, wrongful eviction and defamation (Coverage B).

D. Public Officials Liability

Public Officials Liability (POL) insurance protects a municipality from allegations

that a duly-appointed or elected official engaged in a "wrongful act," a term broadly defined as "any actual or alleged error or misstatement or act or omission of neglect or breach of duty, including misfeasance and nonfeasance . . ." by a municipal official in the discharge of his duties for the municipality. (See sample POL form attached). It is akin to the Directors and Officers (D&O) insurance policies routinely purchased by private corporations. POL insurance is typically written on a "claims-made" basis, which means that it only insures the municipality and its officials for claims first reported during the policy period (or an extended policy period), and which did not occur after the end of the policy period. (Compare POL insurance with automobile and CGL policies which insure against claims for bodily injury or property damage caused by an "occurrence" that takes place within the policy period, regardless of when the claim is actually made.) POL policies typically insure municipalities and municipal officials against claims of civil rights violations.

E. Educators' Legal Liability

Similar to POL insurance, educators' legal liability insurance protects a municipality from claims against its educational entity for the wrongful acts of school officials – typically, the school committee, the superintendent and other administrators. Like POL insurance, educators' legal liability insurance is usually written on a "claims-made" basis.

F. Law Enforcement Liability

Law enforcement liability insurance protects a municipality and its police officers against claims arising out of law enforcement "wrongful acts," activities or duties. Kootenai County v. Western Cas. & Sur. Co., 113 Idaho 908, 911, 750 P.2d 87, 90 (1988) (negligent act of sheriff in executing sale of real property without complying with statutory requirements held covered under law enforcement endorsement to automobile liability policy); LeJeune v. Allstate Ins. Co., 365 So. 2d 471, 479 (1978) (failure of deputy sheriff to secure intersection of highway as funeral cortege passed, which resulted in accident and death of passenger riding in hearse, held covered under professional liability policy issued to sheriff's office). Typically, a law enforcement liability policy protects both the police department and the individual police officers (full-time, part-time, auxiliary and volunteer) against claims of false arrest, malicious prosecution, abuse of process, assault and battery, and violation of a person's civil rights. (See sample law enforcement form attached).

G. Employment-Related Practices Liability

Because most liability policies exclude coverage for claims brought against the insured by an employee (and his spouse or child), a municipality would be wise to purchase employment-related practices liability insurance which protects against claims arising out of allegations of wrongful termination, discrimination,

harassment and retaliation deriving from the employer-employee relationship. In an age when most municipal employees are afforded a variety of statutory protections under (among other provisions) the Family Medical Leave Act (FMLA), the Fair Labor Standards Act, the National Occupational Safety & Health Act (OSHA), and a number of federal and state whistleblower acts, the opportunities for a disgruntled or mistreated employee to pursue a claim against his employer are no longer limited to the wrongful discharge claim. The risks that an employee may be "wronged" because he was not fully compensated for his services, was disciplined, demoted or passed over for promotion, was required to perform a task (or tasks) without adequate precautions taken for his health or safety, or was subjected to an unreasonable invasion of privacy, require a municipal employer to shift those risks, to the extent possible, to an insurance carrier.

H. Workers' Compensation

Worker's compensation insurance (required in nearly all jurisdictions) protects an employer from liability for claims for lost wages and medical expenses made by employees injured on the job. Note that some jurisdictions permit municipalities, unlike private employers, to "elect" whether to provide workers' compensation coverage to employees in lieu of remaining exposed to liability under the common law. *See, e.g.*, Mass. Gen'l Law c. 152, § 25B. As a practical matter, however, few municipalities choose the common law option.

III. Anatomy of an Insurance Policy

In order to better understand an insurance policy and the protections it affords, it is important to break the policy down into its various parts and provisions. Certainly, not all policies are alike. But for illustration purposes, the standard CGL policy can be broken down into the following five (5) parts:

A. Declarations

The Declarations page sets forth basic policy information unique to the insured and the insurance contract. It is the first place to look when attempting to determine whether a particular claim is covered under the policy. The declarations page contains:

- The name and address of the insurer;
- The name and address of the "named insured" – *i.e.*, the legal entity to whom the policy was issued;[1]
- The policy period – *i.e.*, the effective dates of the policy (often a one-year period);

1 Section II – Who Is An Insured – further defines the breadth of those protected under the policy.

- The policy limits – *i.e.*, the maximum amount(s) the insurer will pay in indemnification on behalf of the named insured (or any additional insureds);[2]

- A description of the named insured's business (for underwriting purposes); and

- A list of the forms and endorsements (if any) that comprise the complete policy.[3]

B. Insuring Agreement(s)

The second place to look when interpreting an insurance policy is the insuring agreement. The insuring agreement sets forth the duties and obligations of the insurer and the specific circumstances under which such duties and obligations are triggered. The two primary obligations of a liability insurer are (1) to defend the insured; and (2) to indemnify the insured for covered losses to third parties. Thus, the insuring agreement in Coverage A (Bodily Injury and Property Damage Liability) of a standard CGL policy states, in part, as follows:

We [the insurer] will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply.

The first sentence of the insuring agreement sets forth the insurer's duty to indemnify,[4] and the second sets forth its duty to defend. Note that a policy may contain more than one insuring agreement. The standard CGL policy contains three – one each for Coverages A, B and C. When determining whether a claim is covered under an insurance policy, it is important to review all available coverages.

C. Exclusions

If an insuring agreement applies to a claim, one must next determine whether the coverage afforded is effectively eliminated by one (or more) of the following exclusions. In other words, are the insurer's duties to defend and indemnify excluded in the particular circumstances of this claim? Exclusions are typically designed to eliminate from coverage those risks more suitably protected under

2 Section III – Limits Of Insurance – further explains how the policy limits apply.

3 At times, this list may appear on a separate Form Schedule attached to the Declarations page.

4 The Supplementary Payments provision sets forth several additional payments an insurer is required to make (in addition to indemnifying those sums its insured "becomes legally obligated to pay as damages"), such as court costs and pre-judgment interest.

other insurance policies (*e.g.*, workers' compensation, employer's liability, aircraft and auto), risks deemed uninsurable as a matter of public policy (*e.g.*, harm expected or intended from the standpoint of the insured), risks regarded as business risks of the insured (*e.g.*, work performed or insured's own product), or risks that insurance underwriters cannot accurately estimate in order to calculate a premium (*e.g.*, pollution, war, nuclear incident). *See* Diamond Shamrock Chemicals Co. v. Aetna Cas. & Sur. Co., 258 N.J. Super. 167, 609 A.2d 440 (N.J. Super. Ct. App. Div. 1992).

D. Definitions

Certain terms in the policy appear in quotation marks – *e.g.*, "bodily injury." The definitions of such terms are set forth in Section V of the standard CGL and must be reviewed in order to understand the full scope of the coverage afforded. Thus, "bodily injury," as used in the insuring agreement above, is defined to mean "bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time." In most jurisdictions, courts have reasoned that "bodily injury" does not include mental anguish, humiliation or emotional distress unaccompanied by physical manifestations. The Coverage A insuring agreement, therefore, is typically not triggered by a pure emotional distress claim.

E. Conditions

The insured also owes various duties and obligations to the insurer, many of which are set forth in Section IV, the policy Conditions. Thus, an insured must (among other things) give notice of an "occurrence" to the insurer "as soon as practicable" after a loss, "immediately" send the insurer copies of all suit papers, cooperate in the insurer's investigation, settlement or defense of a covered claim, sign over to the insurer any subrogated rights, and refrain from making any voluntary payments to others without the insurer's consent. If an insured should breach one (or more) of these conditions, the insurer may have a right to disclaim or withdraw coverage, typically upon proof that it suffered prejudice as a result.

In addition, the Conditions further defines the nature of the insured-insurer relationship, by detailing (among other things) the effect on coverage of other insurance available to the insured for the same loss, the effect of the insured's bankruptcy, the insurer's right to conduct a premium audit, and the insurer's duty to treat each insured (the named insured and any additional insureds) as separate and independent for purposes of applying coverage. In other words, the exclusion of one will not automatically result in the exclusion of all.

IV. Handling Insurance Coverage Disputes

On occasion, a municipality and its insurer may disagree on the scope of coverage afforded under a liability policy. While the subject of insurance coverage litigation is beyond the scope of this paper, several points merit brief attention.

A. The "Four Corners" Rule

When interpreting an insurance policy, courts generally apply the same rules of construction as they apply to other contracts. Merchants Ins. Co. of N.H. v. U.S. Fid. & Guar. Co., 143 F.3d 5, 8 (1st Cir. 1998); Allstate Ins. Co. v. Ahlquist, 59 A.3d 95, 98 (R.I. 2013); United Nuclear Corp. v. Allstate Ins. Co., 285 P.3d 644, 647 (N.M. 2012); Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd's, London, 327 S.W.3d 118, 126 (Tex. 2010); Fireman's Fund Ins. Co. of Wis. v. Bradley Corp., 261 Wis. 2d 4, 17, 660 N.W.2d 666, 673 (2003). The function of the court is to determine "the intent of the parties as expressed by the language of the policy . . . [including] what coverage the . . . [insured] expected to receive and what the [insurer] was to provide . . .." QSP, Inc. v. Aetna Cas. & Sur. Co., 256 Conn. 343, 351-52, 773 A.2d 906 (2001).

In determining whether it owes a duty to defend, an insurer should review the allegations of the complaint side-by-side with the language of the policy. Holz-Her U.S., Inc. v. U.S. Fid. & Guar. Co., 141 N.C. App. 127, 128, 539 S.E.2d 348, 349 (2000). Under the familiar "four corners" rule, "[a]n insurer must defend whenever the four corners of a complaint suggest – or the insurer has actual knowledge of facts establishing – a reasonable possibility of coverage." Continental Cas. Co. v. Rapid-American Corp., 80 N.Y.2d 640, 593, N.Y.S. 2d 966, 609 N.E.2d 506, 509 (N.Y. 1993). *See* Estate of Sustache v. American Family Mut. Ins. Co., 311 Wis. 2d 548, 560, 751 N.W.2d 845, 850 (2008) ("The duty to defend is triggered by the allegations contained within the four corners of the complaint."); North Pacific Ins. Co. v. Hamilton, 332 Ore. 20, 24, 22 P.3d 739 (2001) (insurance policy is viewed by its four corners and considered as a whole); Moore v. Continental Cas. Co., 252 Conn. 405, 409, 746 A.2d 1252 (2000) ("If an allegation of the complaint falls even possibly within the coverage, then the [insurer] must defend the insured.")

Moreover, it takes only one potentially-covered claim to trigger the insurer's duty to defend. Under the majority rule, when an action against an insured involves both covered and non-covered claims, "the insurer is liable for recovery of damages on only the covered claims but has a duty to defend the entire action." First Newton Nat'l Bank v. General Cas. Co. of Wis., 426 N.W.2d 618, 630 (Iowa 1988); Auto Club Group Ins. v. Burchell, 249 Mich. App. 468, 481, 642 N.W.2d 406, 412 (2001); Western Cas. & Sur. Co. v. International Spas of Arizona, Inc., 130 Ariz. 76, 79, 634 P.2d 3, 6 (1981).

B. The Duty to Defend is Broad.

"An insurer's duty to defend is expansive and arises when any part of the claim is potentially or arguably within the scope of the policy's coverage . . .." 14 Couch on Insurance § 200:11 (3rd ed. 2012). *See* Sentinel Ins. Co., Ltd. v. First Ins. Co. of Hawaii, Ltd., 76 Hawaii 277, 287, 875 P.2d 894, 904 (1994) ("The possibility [of

coverage] may be remote, but if it exists, the [insurer] owes the insured a defense."); Boston Symphony Orchestra, Inc. v. Commercial Union Ins. Co., 406 Mass. 7, 10, 545 N.E.2d 1156, 1158 (1989) ("It is axiomatic that an insurance company's duty to defend is broader than its duty to indemnify."); U.S. Fid. & Guar. Co. v. Louis A. Roser Co., 585 F.2d 932, 936 (8th Cir. 1978) (same).

C. Ambiguities are Resolved Against Insurers and in Favor of Insureds.

Any uncertainty or ambiguity in the meaning of an insurance policy must be resolved in the insured's favor. Allstate Ins. Co. v. Falgoust, 160 P.3d 134, 138 (Alaska 2007); Anglin v. Gulf Guar. Life Ins. Co., 956 So. 2d 853, 859 (Miss. 2007); Wilkinson v. Citation Ins. Co., 447 Mass. 663, 667, 856 N.E.2d 829, 833 (2006); AIU Ins. Co. v. Superior Court, 51 Cal. 3d 807, 831, 799 P.2d 1253, 1265 (1990) ("In the insurance context, we generally resolve ambiguities in favor of coverage.") Thus, if a word, term or phrase contained in an insurance policy is susceptible of two (or more) reasonable interpretations, the one most protective of the insured's interests will be adopted and applied by the court. Auto-Owners Ins. Co. v. Anderson, 756 So. 2d 29, 34 (Fla. 2000); Gredig v. Tenn. Farmers Mut. Ins. Co., 891 S.W.2d 909, 912 (Tenn. App. 1994); Outboard Marine Corp. v. Liberty Mut. Ins. Co., 154 Ill. 2d 90, 108, 607 N.E.2d 1204, 1213 (1992).

D. Burdens of Proof.

An insured bears the burden of proving the existence of a potential claim for coverage. Barrett Paving Materials, Inc. v. Continental Ins. Co., 488 F.3d 59, 67 (1st Cir. 2007); COMSAT Corp. v. St. Paul Fire & Marine Ins. Co., 245 F.3d 1101, 1107 (8th Cir. 2001); Shanahan v. State Farm General Ins. Co., 193 Cal. App. 4th 780, 785, 122 Cal. Rptr. 3d 572, 576 (4th Dist. 2011); Pelkey v. Gen'l Elec. Capital Assur. Co., 804 A.2d 385, 387 (Me. 2002). In other words, the insured must show that the claim asserted against it potentially falls within the insuring agreement.

However, an insurer bears the burden of proving the application of a particular exclusion. Allmerica Financial Corp. v. Certain Underwriters at Lloyd's, London, 449 Mass. 621, 628, 871 N.E.2d 418, 425 (2007); Colorado Intergovernmental Risk Sharing Agency v. Northfield Ins. Co., 207 P.3d 839, 842 (Colo. App. 2008); American Motorists Ins. Co. v. L-C-A Sales Co., 155 N.J. 29, 41, 713 A.2d 1007, 1013 (1998). If the application of a particular exclusion remains in doubt, the insurer must at least defend the insured, although its duty to indemnify may remain unresolved.

IV. What to do in the Event of an Accident, Occurrence or Claim

A. Investigate

It is important for municipal counsel to react quickly in the event an accident or occurrence takes place, or a potential claim is made, in order to protect the interests

of the municipality. Upon learning of an occurrence that may give rise to a claim, or upon receipt of notice from a disgruntled employee, person or entity with a complaint about alleged mistreatment at the hands of municipal employees or the "unsatisfactory" quality of certain municipal services, counsel should consider taking steps to (1) establish communications with potential claimants (or their counsel); (2) preserve evidence (including emails, videos and other electronic data); (3) identify (and perhaps interview) potential witnesses; (4) interview and provide legal advice to involved employees; (5) advise and update the mayor, selectmen or city council; and (6) if appropriate, adopt and implement corrective measures or policies to avoid recurrence of the alleged event. For these reasons, municipal counsel may wish to remind the executive branch to advise other officials and department heads of the importance of forwarding all complaints or other information regarding any occurrence to the executive immediately.

B. Notice

Give timely *written* notice of any accident or event that may give rise to liability to the municipality's insurance broker and insurers. Typically, notice of an occurrence must be given "within a reasonable time" or "as soon as practicable" – usually within 30 to 60 days. Notice under a "claims-made" policy must be given within the policy period (or the extended policy period.) Under some policies, multiple notices are often required – *e.g.,* in the event of an occurrence or wrongful act, upon receipt of a claim, and upon receipt of suit papers (in which case such papers should be forwarded *immediately* to the insurer.) The consequences of a municipality's failure to give timely notice to an insurer vary from jurisdiction to jurisdiction and from policy to policy. For example, in some jurisdictions, an insurer may deny coverage for late notice under an occurrence policy upon a showing of prejudice.[5] New England Extrusion, Inc. v. American Alliance Ins. Co., 874 F. Supp. 467, 470 (D. Mass. 1995); Brakeman v. Potomac Ins. Co., 472 Pa. 66, 76-77, 371 A.2d 193, 198 (1977). The burden of proving prejudice, however, rests with the insurer. Las Vegas Metropolitan Police Dep't v. Coregis Ins. Co., 256 P.2d 958, 963 (Nev. 2011); Jones v. Bituminous Cas. Corp., 821 S.W.2d 798, 803 (Ky. 1991). The safest course of conduct is to give written notice early and often.

C. If Coverage is Accepted . . .

An insured must cooperate with its insured in the investigation, defense and settlement (if any) of the case. The failure to do so may (like late notice) may threaten available insurance coverage. Cooperation includes (among other things) sharing relevant documents and policies, making the insured's premises or other property available for inspection, examination and testing, providing witness statements and, if necessary, testifying at depositions and/or at trial. Municipal

5 Applicable rules regarding the sufficiency of notice and the right of an insurer (if any) to deny coverage for late notice vary a good deal from jurisdiction to jurisdiction. It is, therefore, important for municipal counsel to familiarize herself with the statutes and case law in her own state.

counsel should, at the very least, monitor the progress of the case and, in some situations, actively join or participate in the defense. A more active role may be called for when (1) the case is of a sensitive nature or has attracted media attention; (2) the defense is being provided by the insurer under a reservation of rights (see below); (3) the municipality is exposed to liability above available policy limits; or (4) the municipality is exposed to injunctive relief and/or any resolution is likely to include a non-monetary component.

Insurance defense counsel owes independent ethical obligations to each of his assigned clients. Thus, if one attorney is assigned to defend the city, the department head and several employees in the same case, municipal counsel should satisfy herself that defense counsel may ethically do so. As municipal counsel, you may be aware of facts or circumstances of which insurance defense counsel is unaware (*e.g.,* prior disciplinary proceedings) that make a joint defense problematic or impractical. You should call such facts or circumstances to the attention of defense counsel so that he may make an informed decision regarding his own ethical obligations. In the event of an actual or potential conflict, it is incumbent upon the insurer to assign separate attorneys to those defendants whose interests are not completely aligned.

D. <u>If Coverage is Denied</u> . . .

1. Demand it in writing. An insurer is obliged to set forth its coverage position in writing, stating the allegations, facts and/or policy provisions upon which it relies to deny any duty or obligation to its insured.

2. Get a second opinion. If the municipality's uninsured exposure is significant, or if the insurer's position will have an impact upon the coverage available for future claims, municipal counsel may wish to retain coverage counsel to analyze the insurer's denial.

3. If you believe a coverage denial was issued in error, ask the insurer to reconsider its position, explaining (in writing) the basis for your belief.

4. If allegations or facts, as developed in the case, should change, or if the plaintiff should amend his pleading to add new claims or counts against the municipality or its officials, retender the defense to the insurer. If it denies coverage again, repeat Steps 1 – 3 above.

5. Consider filing an action for breach of contract and/or for declaratory relief against the insurer.[6] Municipal counsel may

6 In some jurisdictions, an insurer who believes a claim is not covered under its policy is not free to simply deny coverage "but must either defend under a reservation of rights or seek a declaration of

wish to file suit immediately, so that the coverage action coincides with the underlying suit, or may prefer to await the ultimate outcome of the case (by way of dismissal, settlement or judgment) before commencing coverage litigation. Check your local statutes of limitation.

6. If the insurer's handling, investigation or denial were in bad faith or in violation of insurance statutes or regulations in your jurisdiction, consider filing an action for bad faith against the insurer. Again, the filing of such an action should be timed to best protect the municipality's interests and, again, be aware of local statutes of limitation.

7. If appropriate (and feasible), take steps necessary to amend the insurance policy to ensure that future claims of this nature are protected. The insurer may be willing to endorse the policy effective immediately (no doubt upon the payment of an additional premium).

E. If Defense is Offered Under a Reservation of Rights . . .

At times, an insurer may be unable to determine, based on the allegations of the complaint and facts available to date, whether its policy covers a particular claim. In keeping with the principles set forth above, an insurer may, for example, owe the municipality a duty to defend, but its duty to indemnify is still unclear, either because relevant facts remain unknown or in doubt, or because indemnification will depend upon factual findings not yet made by a judge or jury – *e.g.*, was the official's conduct intentional or unintentional? Under such circumstances, an insurer may offer to defend the municipality under a reservation of rights.[7]

A reservation of rights is notice from an insurer that it will agree to assume the insured's defense, but is nonetheless reserving all rights it has based on non-coverage. Motorists Mut. Ins. Co. v. Trainor, 33 Ohio St. 2d 41, 45, 294 N.E.2d 874, 877 (1973). *See* Jim Black & Assocs., Inc. v. Transcontinental Ins. Co., 932 So. 2d 516, 518 (Fla. App. 2nd Dist. 2006) ("Sending a reservation of rights letter and appointing mutually agreeable defense counsel is an appropriate action when an insurance company disputes coverage.") In other words, by sending a reservation of rights letter, the insurer is reserving its rights to withdraw the defense, to deny any duty to indemnify the insured and, in some situations (and jurisdictions), to recover defense costs from the insured.

If an insurer offers to defend the municipality under a reservation of rights:

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no coverage." *See, e.g.,* American National Fire Ins. Co. v. National Union Fire Ins. Co., 343 Ill. App. 3d 93, 101, 796 N.E.2d 1133, 1140 (2003).

7 Often (or alternatively), liability insurers may investigate or defend a "questionable" claim under a similar non-waiver agreement.

1. Follow Steps 1 – 3 set forth above with respect to coverage denials. Get the reservation of rights in writing and, if necessary (or the case is significant), hire coverage counsel for a second opinion. If you believe a reservation of rights letter was issued in error, ask the insurer to reconsider its position, explaining (in writing) the basis for your belief.

2. In some jurisdictions, the reservation of rights letter is a unilateral notice, and does not require consent of the insured. In other jurisdictions, however, a reservation of rights is (in effect) an offer to defend under certain conditions, which the insured has a right to either accept or reject. *See* Iowa Mut. Ins. Co. of De Witt, Iowa v. Meckna, 180 Neb. 516, 527, 144 N.W.2d 73, 80 (1966) (automobile liability insurer does not have right to insist on reservation of rights with its insured as a condition precedent to undertaking defense owed under policy). In such jurisdictions, municipal counsel may consider rejecting a defense tendered under a reservation of rights. To do so, the municipality advises its insurer that it will accept the defense *only if tendered without conditions.* This places the onus squarely on the insurer to either withdraw its reservation of rights (and agree to defend *and* indemnify the entire case), or stand by its original reservation. If the insurer stands by its original reservation, the insured municipality is then free to defend itself against the claim and to resolve it in whatever manner it deems appropriate. Following the outcome of the case, the municipality may then bring an action for breach of contract against the insurer to recover its defense costs and any sums paid in settlement or satisfaction of a judgment.

3. If a municipality accepts a defense under a reservation of rights – either because it has no choice or because it agrees to the insurer's conditions – municipal counsel should still (1) if appropriate, set forth her disagreement with the reservation of rights in writing; (2) monitor the defense and, if developments should warrant, request the insurer to withdraw its reservation; and (3) participate in the selection of defense counsel. While not uniform throughout the states, the general rule is that when an insurer provides a defense under a reservation of rights, the insured is given the opportunity to select defense counsel to be paid for by the insurer. American Family Life Assur. Co. v. U.S. Fire Co., 885 F.2d 826, 831 (11th Cir. 1989); Rhodes v. Chicago Ins. Co., 719 F.2d 116, 120-21 (5th Cir. 1983). Municipal counsel should actively participate in that selection process.

F. Participate in Settlement

If a defense is being provided under a reservation of rights, municipal counsel should be aware that, when and if the parties explore settlement, the insurer may solicit the municipality's participation in the form of a monetary contribution toward the resolution of uncovered counts or claims. This is when a municipality, well-armed with the advice of coverage counsel, should be prepared to "push back" and demand that the insurer settle *all* claims – both covered and "uncovered" – at its own expense.[8]

Whether an insurer must obtain an insured's consent to settle a claim usually depends on the language of the applicable insurance policy. Ordinarily, an insurer defending a claim under a CGL policy need not solicit or obtain its insured's consent to negotiate or enter into a final settlement.[9] Liberty Mut. Ins. Co. v. Thalie Const. Co., Inc., 116 F. Supp. 2d 495, 501 (S.D.N.Y. 2000) (insurer granted exclusive control over settlement is subject to "an implied duty of good faith and fair dealing"); 1 Windt, Insurance Claims and Disputes: Representation of Insurance Companies and Insureds § 5.03, at 306-07 (3rd ed. 1995). Under many professional liability policies, however – *e.g.*, POL, law enforcement liability – an insurer cannot enter into a settlement without the consent of the named insured. 14 Couch on Insurance § 203:10 (3rd ed. 2012). Obviously, this gives a municipality substantial say in whether a case brought against it or one or more of its officials – say the selectmen, town manager, police chief, fire chief, superintendent of schools, or some other high-ranking officer – will be resolved prior to trial. And, since the public perception of a negotiated settlement may tend to stigmatize an appointed or elected official (even though the settlement includes no admission of liability), the municipality may wish to "stand behind" its official by withholding consent from an insurer who, in the municipality's view, is seeking only to save money.

But withholding consent to settle can come with a price. Often, a professional policy will provide that, if the named insured refuses to consent to a negotiated settlement between the plaintiff and the insurer, the municipality will be on the hook for the difference (if any) between the negotiated sum and the amount of plaintiff's final verdict, as well as for the costs of defending the case from the date upon which it could have been settled. This so-called "hammer clause" effectively discourages municipalities from withholding their consent in all but the most notorious or egregious cases.[10] More often, a municipality will grudgingly give is consent to settle (even when it would prefer to seek vindication at trial) simply because it does not wish to face the potential exposure of an adverse verdict.

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8 Note that such an "invitation" from an insurer to participate in settlement may not be permitted in all jurisdictions.

9 The insuring agreement to Coverage A, for example, states in part: "We [the insurer] may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result."

10 For a case in which the court found a "hammer clause" unambiguous, *see* Freedman v. United National Ins. Co., 2011 WL 781919 (C.D. Cal. 2011).