In the Aftermath of Trial

Is There Coverage When Punitive Damages Are Excluded?

By J. Mark Hart

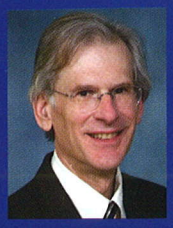
Case analysis shows a balanced and practical approach to the application of insurance contract terms.

Two principles of coverage law are colliding in punitive damages verdicts. The first is the principle that a carrier has no duty to indemnify for a noncovered count. The second is that an insured may sue when the carrier unreasonably failed to settle before trial, exposing him or her to an excess verdict. That collision is increasingly causing posttrial suits when the carrier satisfies the covered compensatory judgment, but denies payment for the punitive damages judgment under a punitive damages exclusion.

Punitive damages exclusions have become widespread over the past 20 years; however, there are only a handful of cases considering what duties, if any, a carrier owes to an insured facing trial on both covered compensatory and noncovered punitive damages claims. The question of coverage becomes urgent following a punitive verdict, when the plaintiff and insured are clamoring for payment, threatening bad faith suits, and the carrier must decide if it has a duty to pay or appeal the noncovered award.

No Duty Lies to Settle a Noncovered Punitive Claim

The cases consistently hold that a carrier does not have a duty to settle a noncovered punitive claim even when coupled with a covered claim. *See, e.g., Lira v. Shelter Ins. Co.*, 913 P.2d 514, 516 (Colo. 1996); *St. Paul Fire & Mar. Ins. Co. v. Convalescent Serv's, Inc.*, 193 F.3d 340, 343 (5th Cir. 1999) (Tex.); *Ross Neely Systems, Inc. v. Occidental Fire & Cas. Co.*, 196 F.3d 1347 (11th Cir. 1999) (Ala.) As a corollary, these cases also hold that a carrier does not have a duty to settle a covered claim in order to avoid a potential verdict on a noncovered punitive claim. *Ross Neely*, 196 F.3d at 1352; *Zieman Mfg. Co. v. St. Paul Fire & Mar. Ins. Co.*, 742 F.2d 1343, 1345–46 (9th Cir. 1983) (Cal. law) ("The proposition that an insurer must settle, at any figure demanded within the policy limits, an action in which punitive damages are sought is nothing short of absurd"); *Seren Innovations, Inc. v. Transcontinental Ins. Co.*, 2006 WL 1390262 *5 (Minn. App. 2006) (unpublished) (a carrier does not have "a duty to settle all claims within the policy limits regardless



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of whether the policy provides coverage for a particular claim"). Further, the fact that the compensatory award exceeded the carrier's settlement offers does not establish that the carrier wrongfully failed to settle.

For example, in *Lira v. Shelter Ins. Co.*, 913 P.2d 514 (Colo. 1996), the court reversed the judgment of the trial court allowing a bad faith failure to settle claim to be submitted to the jury for decision. After drinking, the insured rear-ended another car, fought the other driver, and left his car on the road where plaintiff's auto collided with it. Plaintiff offered to settle for the $50,000 policy limit, but the carrier offered just $10,000 based on its assessment on plaintiff's comparative negligence. The jury at trial returned a verdict for $87,300 in compensatory damages and $87,300 in punitive damages. Pursuant to state statute, the trial court on posttrial motion remitted both verdicts by half (to $43,650 each). The compensatory award, which then fell within the policy limits, was satisfied by the carrier. The carrier did not satisfy the punitive award because the policy did not cover punitive damages.

The carrier's actions must be viewed in light of information it had at the time and not in hindsight.

The insured sued for bad faith failure to settle and obtained a $58,000 judgment. The court of appeals reversed and was affirmed by the state supreme court, which held:

> An insurer who has not contracted to insure against its insured's liability for punitive damages has no duty to settle the compensatory part of an action in order to minimize the insured's exposure to punitive damages.... Thus, if the insurer has no contractual duty to indemnify the insured for punitive damages, the insurer has no tort duty to settle in good faith with regard to punitive damages.... The insured may not later utilize the tort of bad faith to effectively shift the cost of punitive damages to his insurer when such damages are expressly precluded by the underlying insurance contract.

Id. at 516–17. The court concluded, "To hold otherwise would, in practical application, force insurers to settle cases involving punitive damages in order to avoid liability for the same punitive damages in subsequent bad faith actions. Such a result would be contrary to the principle that insurers have no absolute duty to settle in order to protect their insureds from punitive damages." *Id.* at 518. Similarly, in *Zieman Mfg. Co. v. St. Paul Fire & Marine Ins. Co.*, 724 F.2d 1343 (9th Cir. 1983) (Cal. law), the trial court, in granting summary judgment for the carrier ruled, "The proposition that an insurer must settle, at any figure demanded within the policy limits, an action in which punitive damages are sought is nothing short of absurd. The practical effect of such a rule would be to pass on to the insurer the burden of punitive damages in clear violation of California statutes and policy." *Id.* at 1346.

Zieman involved a product liability suit. The policy had a $1,000,000 limit. The carrier defended, but notified the insured that there was no coverage for any punitive award. Plaintiff offered to settle for $250,000, and the insured urged the carrier to accept the offer and was even willing to contribute $20,000 of its own money toward the settlement. The carrier rejected the offer, because it had valued the case at $100,000. At trial the jury awarded $387,000 in compensatory damages and $30,000 in punitive damages. In a later bad faith failure to settle suit, the trial court granted the carrier's motion for summary judgment. The trial court held that the "excess verdict" bad faith failure to settle cases were inapplicable, because the compensatory award was within the policy limits: "the policy limits were never threatened under any view of what happened in the Stewart case." *Id.* at 1346. On appeal, the court affirmed: "St. Paul attempted, although unsuccessfully, to settle the suit against Zieman. The resulting judgment was higher than St. Paul expected, but still well within the policy limits. St. Paul had no absolute duty to settle the claim merely because Zieman risked a punitive award." *Id.* at 1345.

Does a Carrier, Then, Owe the Insured *Any* Duty When a Noncovered Punitive Claim Is Coupled with a Covered Compensatory Claim?

It makes sense that a carrier does not have a duty to settle a noncovered claim. It also makes sense that the carrier has "no absolute duty to settle the [compensatory] claim merely because [the insured] risked a punitive award." *Zieman*, 724 F.2d at 1345. Otherwise, the practical effect would be to insure punitive damages regardless of the policy exclusion or force carriers to suffer exaggerated compensatory claim payments to avoid bad faith liability.

But that leaves a nagging question. Does that mean that a carrier *never* has an exposure when the case goes to trial and punitive damages follow, *regardless* of the carrier's conduct? What if the carrier treated the compensatory claim arbitrarily or capriciously, making a ridiculously "low ball" offer when settlement of the compensatory claim would have settled the entire case and avoided the punitive award? This question has spurred courts to go further in their analyses of a carrier's duty, even after announcing the fundamental rule that a carrier has no duty to settle a noncovered count.

At the outset it is important to distinguish "excess" verdict cases where the verdict is returned on a covered count but exceeds the policy limits from cases where the verdict includes a noncovered count. The proper analysis here is *not* whether the compensatory award exceeded the carrier's offer on the covered claim as would occur in excess cases, or whether an undifferentiated offer to settle (without separate amounts for compensatory and punitive damages) was within policy limits. *See, e.g., Soto v. State Farm Ins. Co.*, 635 N.E.2d 1222, 1224 (N.Y. 1994) ("We conclude that a rule permitting recovery for excess civil judgments attributable to punitive damage awards would be unsound public policy"); *Zieman*, 724 F.2d at 1346.

The proper analysis, then, lies not in parsing or second-guessing the negotiations on the compensatory claim, but rather in examining whether the carrier met the minimal standards for claims handling in reservation of rights cases generally. The courts have given different phrasing to that standard, but the common

statement of the rule is that if the carrier met the minimum standard for handling reservation of rights defenses in that jurisdiction, there was no liability as a matter of law for failure to settle.

Cases Holding No Wrongful Failure to Settle as a Matter of Law

In the following cases there was no liability for failure to settle as a matter of law. In several, the compensatory award exceed the last settlement offer, which again shows that comparison of the compensatory award to the last offer is not the proper test. The carrier's rejection of an undifferentiated offer within the limits that would have settled all claims is likewise not the proper test.

The Alabama Supreme Court forwent the opportunity to address the situation by declining to accept a certified question from the federal court in *Ross Neely Systems, Inc. v. Occidental Fire & Cas. Co.*, 196 F.3d 1347, 1352 (11th Cir. 1999). In the absence of state law on the issue, the Eleventh Circuit decided the case by selecting general principles governing a carrier's duties in reservation of rights cases and affirmed the entry of summary judgment in favor of the carrier.

In that case, a Ross Neely truck driver rear-ended a car stopped at a red light, injuring the passengers. Two passengers settled. The third passenger sued, and the carrier defended the insured under a reservation of rights. Before trial, the carrier offered $35,000 in settlement while the plaintiff demanded $95,000. The trial went poorly for the insured, and the jury returned a verdict for the plaintiff of $45,000 in compensatory damages and $250,000 in punitive damages. The carrier promptly paid the compensatory award. Ross Neely's counsel retained by Occidental submitted a posttrial motion attacking the punitive award. Ross Neely paid the $250,000 and then sued Occidental for bad faith.

In a suit with both covered and noncovered claims, Alabama law does not require the carrier to provide independent counsel for the insured at the carrier's expense because of the conflict of interest that can arise in defending under a reservation of rights. Rather, Alabama law imposes "enhanced duties" upon carriers defending under a reservation of rights. A breach of the enhanced duties waives the coverage defense, but does not give rise to a bad faith action. *See L&S Roofing Supply Co. v. St. Paul Fire & Mar. Ins. Co.*, 521 So. 2d 1298, 1303 (Ala.1987) (establishing enhanced duties); *Twin City Fire Ins. Co. v. Colonial Life & Acc. Ins. Co.*, 839 So. 2d 614, 615 (Ala. 2002) (breach of enhanced duties does not create tort action for failure to settle).

The Eleventh Circuit explained the enhanced duties under Alabama law:

In defending an insured under a reservation of rights, an insurer has a potential conflict of interest. Because the insured may face greater liability than the insurer, whose liability is capped by policy exclusions and limits, the insurer's duty of good faith includes four elements: (1) the insurer must thoroughly investigate the cause of the accident and the severity of the plaintiff's injuries; (2) the insurer must retain competent defense counsel who will represent only the insured; (3) the insurer must fully inform the insured of all developments relevant to its coverage and the progress of the lawsuit, including all settlement offers; and (4) the insurer must refrain from any action that demonstrates a greater concern for the insurer's monetary interest than for the insured's financial exposure.

Ross Neely, 196 F.3d at 1351.

The carrier had no duty to take the possibility of punitive damages against insured into consideration when negotiating settlement for covered claims.

The court found that there was no genuine issue of material fact as to whether Occidental fulfilled its duty of good faith in defending Ross Neely and affirmed summary judgment for Occidental. Applying the enhanced duty factors, the court held first that Occidental conducted an adequate investigation: "Occidental hired independent investigators who interviewed witnesses, investigated the accident scene, examined the police report, and obtained medical records." *Id.* at 1351. The court rejected the insured's argument that Occidental failed to investigate because it did not interview the trooper who had adverse information: "All this information was available from Occidental's investigation or Ross Neely's own sources. The failure to interview the police officer does not create a material issue of fact as to the adequacy of the investigation." *Id.* at 1352.

As to the remaining elements, the court held that Ross Neely did not assert that the defense provided was inadequate and the evidence showed that Occidental kept Ross Neely informed of case developments and settlement offers as the case progressed. "As for the fourth element—acting with a greater concern for Occidental's interest than Ross Neely's—there is no material issue of fact. Merely refusing to settle does not mean the insurer breached its duty," *id.* at 1352. Further, the carrier's actions must be viewed in light of information it had at the time and not in hindsight. An "insurer [is not] under a duty to settle a compensatory damage award merely to minimize its insured's exposure to punitive damages." *Id.* at 1352. *Accord*, *Lira v. Shelter Ins. Co.*, 913 P.2d 514 (Colo. 1996); *Zieman Mfg. Co. v. St. Paul Fire & Marine Ins. Co.*, 724 F.2d 1343 (9th Cir. 1983). Therefore, Occidental was not liable.

In *St. Paul Fire & Marine Ins. Co. v. Convalescent Services, Inc.*, 193 F.3d 340 (5th Cir. 1999) (Tex. law), a federal court also was asked to predict state law. Utilizing a different approach than did the Eleventh Circuit under its prediction of Alabama law in *Ross Neely*, the Fifth Circuit held that (1) the carrier's duty to settle was not triggered unless the claim against the insured was a covered claim, and (2) the carrier had no duty to take the possibility of punitive damages against insured into consideration when negotiating settlement for covered claims.

In this case, plaintiff sued insured CSI for compensatory damages and punitive damages for a near fatal injury arising from decubitus ulcers plaintiff developed in defendant's nursing home that was insured by St. Paul. The ulcers caused loss of skin to the bone, hospitalization, surgery, and skin grafts. Plaintiff demanded $250,000, well within policy limits, with medical damages alone of $80,000. St. Paul counter-offered at $35,000, and the case went to trial resulting in a verdict of $380,000 in compensatory damages and $850,000 in punitive damages. Following the verdict, St. Paul paid the compensatory award but refused to pay the punitive award based on the exclusion in its policy. CSI executed an assignment of its rights against St. Paul in exchange for a covenant to delay levy on the judgment. St. Paul then filed a declaratory judgment and CSI counterclaimed for breach of duty to exercise ordinary care in the defense, evaluation, and settlement of the lawsuit under the Texas state court decision in *G.A. Stowers Furniture Co. v. American Indemnity Co.*, 15 S.W. 2d 544 (Tex. App. 1929) ("the *Stowers* duty"). St. Paul filed a motion for judgment on the pleadings, which the district court granted.

On appeal, the court held that the elements of the *Stowers* duty to settle are (1) the claim is within the scope of coverage, (2) the demand is within the policy limits, and (3) the terms of the demand are such that an ordinary prudent insurer would accept it considering the likelihood and degree of the insured's potential exposure to an excess judgment. *Id.* at 342. The court did find that the *Stowers* duty required that a carrier "exercise the degree of care and diligence when responding to settlement demands within policy limits that 'an ordinarily prudent person would exercise in the management of his own business,'" [but the] "issue of whether the claimant's demand was reasonable under the circumstances, such that an ordinarily prudent insurer would accept it" only arose when the claim was within the coverage of the policy. *Id.* at 342–43. The court affirmed because the failure to settle claim was not actionable, as the punitive verdict was not within the scope of coverage.

The court rejected CSI's argument that St. Paul had a duty to settle because CSI would have paid its share of any demand for noncovered damages to avoid exposure to a large punitive award "if St. Paul had made CSI aware of its internal evaluation that the exposure to a punitive damages award was great." *Id.* at 342. The court held simply, "CSI's argument wholly ignores the most basic proposition that an insurer has no duty to settle a non-covered claim." *Id.*

A quite different approach was used in *Soto v. State Farm Ins. Co.*, 635 N.E. 2d 1222, 1225 (N.Y. 1994), where the insured's assignee sued for bad faith failure to settle. The insured car was driven by another individual who struck and killed two victims. The carrier refused an offer to settle for the policy limits of $100,000. The jury

returned a verdict for $420,000 in compensatory damages and $450,000 in punitive damages against the driver. The carrier paid the compensatory verdict but did not pay the punitive verdict. The plaintiffs took an assignment of the insured's and driver's rights against the carrier and sued for bad faith failure to settle, alleging that the carrier recklessly disregarded the insured's interests with a substantial likelihood of an excess verdict. The trial court granted the carrier's motion to dismiss because the punitive damages in the underlying suit were not properly recoverable as consequential damages for breach of the duty of good faith.

On appeal, the court affirmed on the grounds that insurance for punitive damages is against New York public policy and that the carrier's failure to settle did no more than prevent the insured from escaping the consequences of his own wrongdoing. Thus, the carrier had no duty to take into account the insured's punitive damages exposure when evaluating a settlement offer. The court further held that the punitive damages awarded in the underlying case were not a proper element of damages in a wrongful failure to settle case because those damages were excluded. The court did not foreclose the possibility of an actionable failure to settle; however, it held the damages for such an action are limited to excess liability and mental distress, but not the punitive award itself.

Cases Holding the Failure to Settle Claim Was a Fact Question

In two extreme cases, the carrier adopted the attitude that punitive damages were the "insured's problem." The courts rewarded this lack of concern by sending the carriers to jury trials on wrongful failure to settle claims.

In *Magnum Foods, Inc. v. Continental Casualty Co.*, 36 F.3d 1491 (10th Cir. 1994) (Okla. law), a Little Cesar's Pizza manager raped a 16-year-old employee. Before that event, the manager had been repeatedly reported to company management for lewd behavior and several female employees had refused to work alone with him. The manager also had a prior felony sexual assault conviction that the employer had failed to uncover prior to hiring him, and there were other egregious facts. The victim and her parents sued Magnum, which was insured by CNA.

CNA defended under a reservation of rights. The policy limits were $6,000,000. Plaintiffs offered to settle for $495,000, but CNA would not offer more than $350,000. The jury awarded $675,000 in compensatory damages and $750,000 in punitive damages against the employer, as well as $5 million in punitive damages against the manager.

Magnum filed a declaratory judgment action seeking a declaration of coverage for the punitive award and damages against CNA for bad faith. The district court granted partial summary judgment for CNA, holding that the policy did not cover the punitive award because Oklahoma public policy precludes insurance coverage for willful and malicious acts. But the district court denied summary judgment on the insured's bad faith failure to settle claim. At the trial of the bad faith case, the evidence showed that before trial of the underlying case the CNA adjuster had stated that the danger of a punitive award was the insured's problem and that CNA was not concerned about punitive damages because CNA would not have to pay them in any event. *Id.* at 1507. The jury awarded Magnum $750,000 in compensatory damages and $750,000 in punitive damages (which the insured had settled with plaintiff for $600,000), and the trial court awarded the insured attorney fees for the bad faith claim and for the underlying case.

On appeal, CNA argued that the trial court erred in denying its motions for directed verdict and judgment notwithstanding the verdict. The court rejected those grounds but remanded for a new trial because the bad faith claim "was improperly based on proof that included the $600,000 paid to settle the state court punitive award against Magnum." *Id.* at 1502. In other words, the failure to settle claim could not include as damages the amount of the excluded punitive verdict.

The court rejected the carrier's argument that it had no duty to settle because that duty is triggered only by excess exposure and not a potential verdict on a non-covered count. The court ruled that the carrier owed the following duty:

> When an insurer owes or undertakes the duty to defend its insured in a suit seeking both insured and uninsurable damages, it has the duty to conduct settlement negotiations in good faith as part of that defense. For one thing, this includes warning the insured of any potential exposure to him and apprising him of settlement opportunities within a reasonable time after they are presented.

The carrier had no duty to take into account the insured's punitive damages exposure when evaluating a settlement offer.

> We hold that here, where both compensatory and uninsurable punitive damages are sought, and CNA assumed the defense of the entire suit under the obligations of the policies, the presence of the punitive claim did not absolve CNA from its obligation of good faith in handling the entire case. That duty of good faith does not include settlement or a contribution to settlement by CNA of the uninsurable punitive claim. We are convinced, however, that CNA's duty of good faith included working cooperatively with Magnum throughout in both defending and attempting to settle the entire case, with fair consideration given to Magnum's concerns because of its exposure to the uninsured punitive claim. The good faith duty of CNA thus required cooperative efforts by CNA with Magnum throughout to handle and settle the entire case.... The jury should also be told that CNA's duty of good faith and cooperation with Magnum did not obligate CNA to make more than a reasonable payment to settle the covered compensatory damages liability to avoid the uninsurable punitive exposure of Magnum.

36 F.3d at 1506 (internal citations omitted).

The court held that the district court properly denied CNA's motions for directed verdict and JNOV because the claims rep-

resentative initially treated the claim as "merely a sex discrimination case for settlement purposes," the case was perceived as more dangerous as it moved closer to trial but CNA failed to take those developments into account, the senior claims representative reviewed the file the day before mediation (that gave her only a short period to make her evaluation), CNA did not increase its final offer despite defense counsel's recommendation, and CNA rejected plaintiff's counsel's offer to return to mediation shortly before trial. *Id.* at 1507. To top it off, the claims representative told plaintiff's counsel and the insured's chief financial officer that punitive damages were "the insured's problem." *Id.* at 1507.

The court rejected the carrier's defense that it had a bona fide belief in the defense of the employer-insured (and not the manager):

> We believe that where, as here, there is a substantial risk of a large verdict for which the insured will be held liable, an insurer may not refuse to cooperate with its insured in settling claims merely because the insurer has an honest belief in its ability to defend the insured.... If an insurer fails to act cooperatively to reach a settlement—for example, by refusing to make a reasonable offer to settle at least the insured portion of the claim—then the insurer's conduct may be reasonably perceived as tortious, and the trial court may submit the issue of bad faith to the jury.

Id. at 1508.

The court held that in a retrial (1) the jury should not consider the insured's payment of $600,000 to settle the punitive award, and (2) the duty of good faith "did not obligate CNA to make more than a reasonable payment to settle the covered compensatory damages liability to avoid the uninsurable punitive exposure of Magnum." *Id.* at 1506. Therefore, *Magnum* stated sound principles of law. It was the carrier's failure to abide by even minimal claims handling standards for reservation of rights defenses that made the failure to settle the case one for the jury and not one for summary adjudication, as in the cases discussed in the preceding section.

Lastly, in *Ging v. American Liberty Ins. Co.*, 423 F.2d 115 (5th Cir. 1970) (Fla. Law), the Fifth Circuit reversed the trial court's grant of summary judgment and held that, where the carrier undertook the complete defense of a suit against insured seeking compensatory damages and uncovered punitive damages, the insurer had a "duty of good faith... as to the entire undertaking." *Id.* at 116. This case, too, involved poor conduct by the carrier that was found to fall short of even minimal claims handling standards.

The insured, Martin, injured Ging's decedent in a car accident. Ging sought compensatory and punitive damages. Ging demanded $55,000, while the carrier offered $3,500. Then, recognizing Martin had very limited personal financial resources, Ging offered to settle "for the amount of the insurance coverage." The carrier declined to pay the policy limits. Prior to trial, the carrier informed Martin that it was defending the suit on his behalf, the suit sought uncovered punitive damages, Martin could retain his own counsel, and the carrier reserved its right not to pay punitive damages. The carrier, claim representative and retained defense counsel all knew an award of punitive damages was likely but did not inform Martin of this assessment. They also did not inform Martin of any offer of settlement until two weeks before trial and then only in the context that the company's offer was adequate. They did not explain that proof of Martin's limited finances might keep the punitive damage award to a minimum or that Martin could contribute with the carrier toward settlement. Martin lived far out of state and did not appear at trial. The carrier and defense counsel did not seek a continuance when Martin failed to appear at trial. The jury awarded compensatory damages of just under $15,000 and punitive damages of $25,000.

A posttrial motion reduced the compensatory award to $11,195 (which the carrier paid) but no posttrial motion was made on the punitive award. The carrier waited until five and a half months after trial—and 13 days before the appeal date expired—to inform Martin of the verdict and then told him that he would have to retain his own counsel to appeal the punitive damage award. Martin assigned his rights against the carrier to plaintiff in exchange for a covenant not to levy. Plaintiff sued the carrier under the assignment for failure to settle.

The Fifth Circuit held that where the insurer undertakes a defense of the entire case, the insurer must (1) apprise the client of settlement opportunities; (2) warn the client of the danger of punitive damages; (3) advise the client of the outcome of the litigation; (4) advise the client of any proceedings that might lessen the financial impact upon him; and (5) conduct settlement negotiations in good faith to protect the interests of the insured wherever those interests might be divergent from the interests of the carrier. As to the latter element, the court added, "an insurance company—once having undertaken the defense of an action—may properly consider its own interests in conducting the litigation or settlement negotiations, but in so doing it may never forget the interest of its Assured." *Id.* at 120. The court reversed summary judgment and remanded the case for trial.

Conclusion

Several principles emerge from the developing cases on the duty to settle when punitive damages are excluded. First, carriers do not have a duty to settle a noncovered count, including a noncovered punitive count. Second, carriers do not have a duty to settle the covered claim in order for the insured to avoid exposure on the noncovered punitive claim. Third, with these principles in mind, carriers nonetheless have general duties in cases with both covered and noncovered claims. These duties are more in the nature of general claims handling processes. They vary among the states, but a general, common denominator is that the carrier must work cooperatively with the insured to keep the insured informed, provide a competent defense, and not put the carrier's interests ahead of the insured's financial risk. Stated another way, the carrier should work cooperatively with the insured to attempt settlement of the entire case when feasible. Regardless of phrasing, the duty does not include settlement of uncovered punitive claims and, accordingly, does not require the carrier to offer more than a reasonable amount in order to settle the covered compensatory claim. Certainly, the duty does not include paying exorbitant amounts on compensatory claims. *See Magnum*, 36 F.3d at 1506; *Ross Neely*, 196 F.3d at 1351–52.

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is applicable depends on a determination of who hosts, owns, or controls the electronic space. The ISO form does not define the terms "chatroom" or "bulletin board." Therefore, a court will have to determine the scope of those terms. Cases involving claims directly against entities such as Facebook, Myspace, and Twitter may provide some guidance about whether courts have deemed individuals responsible for defaming information. The Communications Decency Act of 1996 addresses the defamation-related liability of service providers. 47 U.S.C. §230. While there is an argument that this exclusion is limited to chatrooms or bulletin boards owned by an insured business, a court may not interpret this exclusion so narrowly. A strong argument exists that this exclusion eliminates coverage for a defaming party's use of a personal web page on a social networking site. However, the authors have been unable to find any reported cases that provide guidance on how courts would likely interpret this exclusion.

If these exclusions do not apply based on the allegations of the complaint, the facts, and the applicable law, a CGL insurer will have the duty to defend and perhaps to indemnify an employer or employee if they have operated within the scope of employment. However, in some circumstances the exclusion against chatrooms and bulletin boards may support denying coverage in a broad sense.

Conclusion

Social networking has transformed the way that we communicate and has also become a breeding ground for litigation. Whether lawsuits take the form of defamation, harassment, discrimination or other claims, insurance companies and the attorneys who work for them should be aware of the strengths and weaknesses of the companies' policies. Since social networking claims thrive in an underdeveloped and evolving area of the law, seeking declaratory judgments before denying claims could prove prudent if the claims fall on the border between coverage and defenses. A homeowners policy may provide coverage for a social networking defamation claim a long as the jurisdiction permits recovery for reckless or negligent defamation. A CGL policy may also provide coverage for social networking defamation, or it may at least trigger a duty to defend under Coverage B, unless one of the exclusions applies. Cyber-liability claims are likely to increase and insurance policies must evolve to entice homeowners and businesses to subscribe to special cyber-policies. Some efforts have been made to address such claims through policy language in a CGL, but the efficacy of exclusionary language is open to debate. FD

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Most failure to settle cases in this context should be decided as a matter of law for the carrier on motions for judgment on the pleadings or on motions for summary judgment, particularly where the carrier followed standard reservation of right processes. Where it is necessary to examine if the carrier complied with the minimal claims handling process when defending under a reservation of rights, this element can usually be shown based upon abbreviated discovery or evidence. The process should not be permitted to devolve into wholesale "second-guessing" of settlement offers or disregard of the rule that a carrier does not have to pay an exorbitant sum on the compensatory claim to avoid a trial on the punitive claim. Otherwise, the danger is that "the exception will swallow the rule," and parties can manipulate the system to try to force the carrier to pay monies beyond what is required by the insurance contract, particularly by making exorbitant compensatory demands that force the case to trial and then "setting up" a posttrial bad faith failure to settle claim.

In sum, the law presently seems balanced. The cases apply the terms of the insurance contracts by not expanding coverage to noncovered claims, while protecting insureds against arbitrary or capricious failures to follow fair claims handling processes in reservation of rights defenses. Hopefully, the law will continue to proceed in a balanced and practical fashion. FD

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ating a declaratory judgment action against the policyholder seeking a declaration that the insurer does not have a duty to defend or indemnify the policyholder in connection with the text-message blasting lawsuit. By initiating a declaratory judgment action, an attorney will ensure that he or she can assert all available coverage defenses on behalf of an insurer. By denying a policyholder's claim for coverage and failing to initiate a declaratory judgment action, an insurer's attorney risks losing the ability to assert potentially successful coverage defenses. *See, e.g., Employers Ins. Of Wausau v. Ehlco Liquidating Trust*, 186 Ill. 2d 127, 150–51 (1999) (finding that if an insurer fails to either defend a policyholder under a reservation of rights or seek a declaratory judgment that there is no coverage and is later found to have wrongfully denied coverage, the insurer is estopped from raising policy defenses to coverage).

Conclusion

Although text-message blasting lawsuits are becoming increasingly common, insurers do not need to worry about increased exposure as long as their attorneys appropriately analyze the duty to defend when claims for coverage arise. Insurers can likely deny coverage for damages resulting from violations of the TCPA resulting from the transmission of unsolicited text message advertisements based upon the TCPA exclusions that are contained in most insurance policies. However, attorneys should more carefully analyze an insurer's duty to defend its policyholder against common law claims included in text-message blasting lawsuits. As with all issues of insurance coverage, insurers should consult an attorney before denying coverage to a policyholder. FD