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### **BREACH OF DUTY TO DEFEND DOES NOT WAIVE POLICY DEFENSES**

In a hearing loss case, the Louisiana Supreme Court decided that the employer's insurer, who breached its obligation to defend by *withdrawing* the defense of the insured and was in bad faith, did not waive its policy defenses. Arceneaux v. Amstar Corp., 2010-2329 (La. 07/01/11), 66 So.3d 438. In 1999, four employees of Tate & Lyle North American Sugars, Inc. ("T&L") filed an action against T&L for damages from noise exposure during their employment at T&L's Domino Sugar Refinery. The period of alleged noise exposure was between 1947 and 1994. Continental Casualty Insurance Company ("Continental") issued eight general liability insurance policies to T&L covering bodily injury occurring between March 1, 1963 and March 1, 1978. Each of the policies contained exclusions for bodily injury to T&L's employees arising out of the course and scope of their employment (as employee claims are normally covered by workers' compensation). However, in the last policy covering the period March 1, 1975 to March 1, 1978, the employee exclusion was deleted by special endorsement on December 31, 1975.

When T&L notified Continental of the lawsuit, Continental retained a firm to defend T&L, which enrolled as co-counsel with T&L's counsel. Continental did not reserve its rights to contest coverage or assert any coverage defenses in connection with its defense of those claims. [An insurer who unconditionally undertakes the defense of its insured with knowledge of a coverage defense has been held to have waived that coverage defense. Stepore v. Masco Construction Company, Inc., 93-2064 (La. 09/18/94), 643 So.2d 1213.] In order to preserve its rights to assert coverage defenses while undertaking the representation of an insured, an insurer must issue a reservation of rights letter or obtain a non-waiver agreement with the insured.

In April 2001, the plaintiffs filed their first amending petition adding 125 new plaintiffs to the suit, all alleging exposure to noise between 1947 and 2001. Due to the large number of plaintiffs, the case was tried in flights of 15 plaintiffs by bench trial. [The plaintiffs obtained a bench trial by stipulating that damages per plaintiff did not exceed \$50,000, the threshold for jury trials under La. C.C.P. Article 1732(1).]

The trial was continued, and T&L settled the first flight of 15 plaintiffs for \$35,000 per plaintiff on May 9, 2003, without Continental's consent. One week after Continental was notified of the settlement, it withdrew the defense by letter, disclaiming liability based on the exclusions in the policy for injuries to T&L's employees. Continental mistakenly believed that all of the policies contained such employee exclusions. Continental also stated that it reserved its right to disclaim coverage to the extent that any bodily injury didn't take place during one or more of the Continental policy periods and issued the same reservations with respect to any future litigation regarding these policies.

In July 2003, T&L sued Continental as a third party defendant. T&L sought indemnity for the amounts it paid to plaintiffs, defense costs and bad faith penalties under La. R.S. 22:658. In August 2003 and April 2004, plaintiffs filed second and third amending petitions adding Continental as a defendant and adding 160 new plaintiffs. The Court described the new plaintiffs added by these petitions as "post--denial plaintiffs," while the plaintiffs in the original and first supplemental petition, who were in the suit before the denial of coverage letter was issued by Continental, as "pre-denial plaintiffs."

In October of 2004, the trial court granted a summary judgment in favor of T&L, holding Continental had waived its policy defenses as to the pre-denial plaintiffs. The trial court held that because Continental had not secured a non-waiver agreement or issued a reservation of rights letter, but participated in T&L's defense for a period of four years, it had waived its policy defenses. That decision was affirmed by the Court of Appeal in December of 2005, and became a final judgment when Continental did not file a writ application with the Louisiana Supreme Court.

On November 11, 2004, T&L submitted defense bills to Continental for the first time. After reviewing the policies, Continental realized that there were in fact 26 months (January 1976 through March 1978) when the employee exclusion was deleted. Continental offered to pay its prorata share of the defense bills (based on other insurers and uncovered periods), but the offer was rejected. After attempts to get other insurers to share the cost of defense failed, Continental notified T&L that it would pay 100 percent of the defense costs and defend all the claims going forward under a full reservation of rights. On April 6, 2005, Continental paid T&L \$1,419,168.95, or the full amount of the defense costs to date. Shortly before the trial of the second flight of plaintiffs, on April 14, 2005, T&L announced that it had again unilaterally entered into a settlement with all the remaining plaintiffs for \$35,000 a plaintiff who met certain criteria. Based on that settlement, T&L made payments that included 101 pre-denial plaintiffs and 116 post-denial plaintiffs.

The third party demand against Continental was tried in August, 2005 before Hurricane Katrina hit. Following the destruction of the court record by Hurricane Katrina and a partial reconstitution of same, the trial court rendered judgment in favor of T&L on April 7, 2006 in the amount of \$9,848,442.33, exclusive of interest and costs. The Court held Continental liable for (1) indemnification for the full amount of the settlements of the 217 pre-denial and post-denial plaintiffs; (2) penalties under La. R.S. 22:658 of 25 percent of the \$7,595,000 in indemnity for the 217 claims and \$1,149,168.95 in defense costs (already paid by Continental); and (3) interest from the date of judicial demand (\$1,104,274.33). The trial court found Continental was liable for indemnity of the post-denial plaintiffs' claims on the basis of waiver, even though those plaintiffs filed suit after Continental had issued its letter denying coverage. The trial court used a "relation back" theory to find that the post-denial plaintiffs' claims related back to the time of the

pre-denial claims. Continental's waiver as to the pre-denial claims (earlier decision) also applied to the post-denial plaintiffs. The decision meant Continental was forced to cover claims of T&L employees regardless of when they were exposed. The trial court held that all settlements were reasonable and ordered penalties under La. R.S. 22:658 for the failure to pay settlements and failure to pay costs of approximately \$1,400,000 within 30 days from when T&L submitted the costs to it on November 11, 2004.

On this appeal the Fourth Circuit affirmed in part, modified in part, reversed in part, and remanded the case to the district court. The Court of Appeal considered the issues on appeal as (1) whether Continental's waiver expanded the period of Continental's coverage beyond its policy period, the 15 years from 1963 to 1978; and (2) whether Continental's waiver applies to the post-denial plaintiffs. The court said yes to the first question, but it reversed the application of the waiver to the post-denial plaintiffs, because the relation back theory could not support extending the waiver of policy defenses to post-denial plaintiffs. The Court of Appeal affirmed that the settlements were reasonable. The Court also reduced the penalty from 25 percent to 10 percent because the actual breach of the duty to defend occurred prior to the effective date of the amendment which changed the penalty from 10 percent to 25 percent. Continental paid \$4,548,255 for the full amount of the indemnity for the pre-denial plaintiffs and paid the 10 percent penalty, \$1,372,378.

The district court ordered cross motions for summary judgment by Continental and T&L on the issues remanded by the Court of Appeal. In its reasons for judgment following a hearing on cross-motions for summary judgment, the trial court held Continental liable for indemnity for all the post-denial claims, based on Continental's breach of its duty to defend.

On appeal of this decision, the Court of Appeal reasoned that although these post-denial plaintiffs had not yet filed their claims when Continental issued its reservation of rights letter and terminated its defense of T&L, Continental knew or should have known or expected more claims at that time. The Court also stated that the initial lawsuit was filed as a cumulation of actions which by its very nature indicates future claims would be added, and 131 plaintiffs were added in 2001. Continental's termination of its defense in 2003 was wrongful, because the employee exclusion did not exist for December 31, 1975 through March 1, 1978. Judge Paul Bonin strenuously objected. In his dissent, he explained that this Court of Appeal had already held the waiver did not apply to post-denial plaintiffs. Yet, the trial court on remand used the waiver again to justify the full indemnity award. A trial court is prohibited from revisiting an issue decided by a court of appeal on a writ or appeal by the "law of the case" doctrine. Nevertheless, the Court of Appeal affirmed the \$4,060,000 indemnity award.

The Louisiana Supreme Court granted writs to determine whether the award of \$4,060,000 in indemnity can be based upon Continental's breach of its duty to defend. The insurer's obligation to defend suits against its insured is broader than its liability for damage claims. Yount v. Maisano, 93-1276 (La. 11/29/93), 627 So.2d 148. Assuming all of the allegations of the petition are true, and that there would be both coverage under the policy and liability to the plaintiff, the insurer must defend the insured. The allegations of the petition are liberally construed to determine whether they set forth grounds which bring the claim under the insurer's duty to be to defend.

The petitioners' alleged bodily injuries from noise exposure were over the period 1947 to 2001, which falls within the time the employee exclusion was not in effect. The court noted the

petitions do not unambiguously exclude coverage, and Continental breached its duty to defend by withdrawing its defense in June of 2003. The issue is whether Continental waived its policy defenses, including coverage period and employee exclusion, by breaching its duty to defend T&L. The Louisiana Supreme Court wrote: "We find that it did not."

When an insurer, with knowledge of facts indicating non-coverage under its insurance policy, assumes or continues insurer's defense without obtaining a non-waiver agreement to reserve its coverage defense, the insurer waives such policy defense. Steptore, supra. Where an insurer undertakes to defend an insured with knowledge of facts indicating non-coverage under the policy, the insured is led to believe the insurer has relinquished that right and acts accordingly. From that point, the insured has the right to believe the insurer's attorney is acting in the insured's best interest without regard to coverage defenses the insurer has seemingly relinquished. As opposed to that view, a *breach* of a duty to defend (as what happened in this case before the 160 plaintiffs were added in 2003-4) has nothing to do with the waiver of rights in the insurance context. When the insurer breaches its duty to defend, it is not misleading the insured into believing there could be coverage under the policy, as Continental did regarding the post-denial plaintiffs. The insurer is not manifesting an intent to relinquish its right to deny coverage under the policy; it is doing so expressly denying coverage under the policy. In such case waiver principles do not apply. While a breach of the obligation to defend may cause a waiver of certain policy provisions or conditions that are attendant to the obligation to defend, it does not extend to the provisions of the policy related to coverage.

The Supreme Court wrote that the trial court's imposition of waiver of coverage defenses based on the breach of the obligation to defend is also not supported by the law. In fact, the trial court imposed the penalty of striking defenses on top of the penalties provided by law which are designated in La. R.S. 22:658 (now La. R.S. 22:1892). The remedy fashioned by the district court imposed a result that permits the insured to reap a windfall of potentially enormous profits far beyond the natural consequences of the insurers' bad breach faith of the duty to defend and far beyond the scope of the insurer's contractual undertaking. The \$4,060,000 indemnity award for the post-denial claimants is reduced, based upon Continental's coverage defenses that only 26 months of the much longer period (approximately 555 months) under the policies provided coverage. Continental only owed a prorated share for that time period, based on the dates when the employee exclusion was not in effect. Continental's motion for summary judgment makes remand unnecessary, and T&L is awarded for the indemnity the amount of \$174,090.92.

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