

# Insured's Breach of Cooperation Clause Negates Coverage for Underlying Action

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The United States Court of Appeals for the Eighth Circuit, applying Missouri law, has held that an insurer had no duty to defend or to indemnify when the insured breached the cooperation clause by selecting its own counsel and controlling the defense of an underlying matter. *Heubel Materials Handling Co. v. Universal Underwriters Ins. Co.*, 2013 WL 331587 (8th Cir. Jan. 30, 2013). The court also held that the insurer did not need to demonstrate actual prejudice resulting from the breach to deny coverage.

The insurer issued a general liability policy to a materials handling equipment dealer. The policy gave the insurer the right and duty to defend any lawsuit for covered damages and required the dealer to cooperate and assist the insurer "in the investigation, settlement, defense, enforcement of contribution or indemnification." The dealer also participated in a mandatory defense and indemnification program for products liability lawsuits with an equipment manufacturer. The indemnification program required the dealer to "fully cooperate" with the manufacturer and its defense counsel.

The dealer was named in a personal injury lawsuit that alleged that the claimant was injured while operating a piece of equipment that the dealer had serviced. The manufacturer was not named as a defendant in this lawsuit. The dealer immediately notified the manufacturer of the lawsuit, and the manufacturer paid for and controlled the defense of the lawsuit. Approximately six months after the lawsuit was filed, the dealer also gave notice to its insurer, which agreed to defend the dealer subject to a reservation of rights based on late notice. The insurer also asked the dealer to identify other relevant insurance policies.

The dealer filed an action seeking a declaratory judgment that, under Missouri law, the insurer's reservation of rights entitled the dealer to select defense counsel and to control the defense of the underlying action. The insurer then withdrew its reservation of rights and offered to retain counsel for the dealer and reimburse defense costs incurred to date. The insurer also advised the dealer that the dealer would be obligated to help the insurer pursue indemnification from the manufacturer. In response, the dealer added a count to the coverage action seeking a declaration that the insurer's requirement that the dealer assist the insurer in pursuing indemnification created an actual or potential conflict of interest that allowed the dealer to select defense counsel and control the defense of the underlying action. The insurer counterclaimed for a declaration that the insured's lack of cooperation released the insurer from its coverage obligations, including the duty to defend.

The dealer argued that the dealer had no obligations under policy's the cooperation clause because of either the insurer's reservation of rights or a conflict of interest between the dealer and the insurer. The dealer also asserted that, to the extent the dealer breached the cooperation clause, any potential prejudice to the insurer was negated by the insurer's inability to pursue an indemnification claim against the manufacturer.

First, the court rejected the argument that the insurer's refusal to concede its indemnification claim against the manufacturer was a reservation of rights that entitled the insured to control the defense of the underlying action. Although Missouri law allows an insured to reject an insurer's reservation of rights and to control the defense of a matter if the reservation is not withdrawn, the insurer here withdrew its reservation of rights. Furthermore, its demand that the dealer cooperate with its pursuit of indemnification was not a reservation to disclaim coverage for the underlying suit at a later time and therefore did not qualify as a reservation of rights that entitled the dealer to control the underlying litigation. In addition, the court noted that the only conflict of interest between the parties was that the insurer's enforcement of the cooperation clause in its policy would require the dealer to breach the competing cooperation clause in connection with the manufacturer's indemnification program. The court rejected the dealer's position that the insurer provided primary coverage for the underlying suit while the manufacturer simultaneously provided primary control of the defense of the underlying suit and noted that nothing in the plain language of the liability policy suggested "that the parties intended such a non-traditional arrangement." The dealer therefore breached the cooperation clause when it refused to allow the insurer to control the defense of the underlying action.

Next, the court found that the dealer's breach of the cooperation clause prejudiced the insurer by denying it the opportunity to pursue its indemnification claim against the manufacturer in conjunction with the underlying lawsuit by impleading the manufacturer in that suit. The court ruled that this harm was not "too speculative" and predicted that the Supreme Court of Missouri would not require the insurer to demonstrate "actual prejudice" in the underlying lawsuit.

Finally, the court evaluated the dealer's contention that the insurer would have been precluded from pursuing indemnification even if it had controlled the defense in the underlying action. The court concluded that the dealer did not have the right under the policy to instruct the insurer not to pursue its indemnification claim. Although the policy's subrogation provision stated that the dealer could instruct the insurer not to pursue subrogation rights, the court distinguished between subrogation and indemnification claims and noted that the insurer's rights against the manufacturer would not necessarily arise as a subrogation claim. Furthermore, the policy did not contain a provision that allowed the insured to request that the insurer not pursue indemnification claims. The court also concluded that the manufacturer's indemnification was enforceable with respect to the underlying suit. The court therefore agreed that the insurer suffered substantial prejudice from the dealer's breach of the cooperation clause and was justified in denying coverage for the underlying lawsuit on that basis.