

Pleadings Test, One Claim-All Claims Principle Determine Insurer's Obligations Requiring Advancement of Defense Costs

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A state appellate court, applying Ohio law, has held that legal standards regarding the duty to defend are applicable in determining whether a claim potentially falls within coverage under a policy requiring the advancement of defense costs and that, so long as any of the underlying claims against an insured is potentially covered, an insurer must advance costs for all claims against that insured. *The Am. Chem. Soc'y v. Leadscope, Inc.*, 2005 WL 1220746 (Ohio Ct. App. May 24, 2005).

This insurance dispute stemmed from a case involving a number of causes of action against four insureds. Three of the insureds were former employees of the company that brought suit. The suit against them alleged that they committed conversion of property belonging to their former company. The fourth insured was a new corporation formed by the three former employees and was also named in the lawsuit, although not for conversion.

The insureds provided notice of the underlying suit and requested that the insurer advance legal costs as provided for under the policy. The insurer denied coverage on a number of grounds and refused to advance defense costs. This resulted in the insureds bringing a third-party complaint against the insurer. The trial court held that, since the policy did not expressly exclude the cause of action for conversion, the insurer was required to advance defense costs for all the underlying claims. This appeal ensued.

The appellate court first considered the trial court's determination that the "pleadings test" applied to determine whether the insurer was required to advance defense costs. According to the court, the "pleadings test" provides:

The test of the duty of an insurance company, under a policy of liability insurance, to defend an action against an insured, is the scope of the allegations of the complaint in the action against the insured, and where the complaint brings the action within the coverage of the policy the insurer is required to make defense, regardless of the ultimate outcome of the action or its liability to the insured

Where the insurer's duty to defend is not apparent from the pleadings in the action against the insured, but the allegations do state a claim which is potentially or arguably within the policy coverage, or there is some doubt as to whether a theory of recovery within the policy coverage has been pleaded, the insurer must accept the defense of the claim.

The appellate court also noted the Ohio's "one claim-all claims" principle further requires that an insured that is obligated to defend one claim arising from an occurrence must defend all claims arising from the same occurrence, citing *Preferred Mutual Insurance Co. v. Thompson*, 23 Ohio St. 3d 78, 80 (Ohio 1986). In response to the insurer's contention that the "pleadings test" and the "one claim-all claims" principle were limited to duty-to-defend policies unlike the advancement policy at issue, the court noted that Ohio law did not support such a distinction and found both standards applicable in determining the insurer's duty to advance defense costs. Thus, if any underlying cause of the action against a defendant was potentially covered, the insurer was required to advance defense costs for all claims against that defendant, regardless of whether all were causes of action ultimately subject to coverage.

The court then examined the conversion claim against the three individual insureds to determine if it potentially was covered. The court held that the conversion claim was necessarily founded on an employment agreement. Thus, the court determined that the conversion allegations were potentially excluded under the policy's exclusion for claims "alleging, arising out of, based upon or attributable to any actual or alleged contractual liability[.]" Using the "plain and ordinary meaning" of the terms "contractual" and "liability" the court concluded that allegations that the insureds violated their employment agreements necessarily alleged "contractual liability." The court next examined the terms "alleging, arising out of, based upon or attributable to." Under the plain meaning of these terms, in order for the exclusion to apply, the court indicated that the conversion claim must have "originated from, grown out of, or flowed from the actual or alleged obligations, responsibilities, and duties imposed" under the employment agreements. The court concluded that this was not the case, determining that the claim for conversion could have stemmed from tortious activity or otherwise have arisen absent a contract. The court noted that a mere reference to contractual liability without the claim being based on such was insufficient to trigger the exclusion. Otherwise, the court concluded, "pleading an alternative theory in a separate claim that included an allegation of contractual liability would exclude the other claims in the complaint even if they clearly were not based upon contractual liability."

The court next addressed the insurer's assertion that its exclusion for "gaining in fact of any profit or advantage to that an insured was not legally entitled" also precluded coverage for the alleged conversion. The insurer contended that the allegations of conversion alone were sufficient to trigger this exclusion. However, the court noted that the term "in fact" required a final adjudication that the profit was illegally derived. Only after such adjudication could the exclusion serve to bar coverage.

The court went on to reject two other potential defenses to coverage for the conversion claims raised by the insurer. First the court rejected the applicability of certain exclusions that limited covered acts or omissions to those committed by employees. The court held that if conversion occurred, it necessarily took place while the insureds were employees and, thus, the exclusions were inapplicable.

The court also rejected the insurer's assertion that the underlying actions were excluded from coverage by the policy's definition of "loss." The definition of loss was limited to suits for "damages" and specifically excluded matters deemed uninsurable at law. In this case, the underlying suit sought both damages—compensatory as well as punitive and exemplary, which are uninsurable at law—and equitable relief. The court concluded that since at least part of the suit was for damages, and since at least some of those damages are insurable at law, the policy's definition did not relieve the insurer of its obligation to advance defense costs. Accordingly, having rejected all of the insurer's arguments as to why the conversion counts were not covered, the appellate court concluded that the insurer was required to advance defense costs for all insureds named in the conversion counts.

The court then turned to the claims made against a fourth insured, the company. There were three claims against that company, but none were for conversion. The court first examined the assertion that this insured misappropriated trade secrets. A clause in the policy excluded coverage for the "insured company only, for any alleged misappropriation" of trade secrets or other IP rights. Thus, the court held there was no duty to advance defense costs based on this exclusion. Similarly, the court found that there was no duty to advance defense costs based on alleged violation of common-law unfair competition by this the company due to the policy's exclusion for alleged "common-law violation[s] with respect to business competition and unfair trade practices." With respect to the final claim against the policyholder for an implied license to use the technology at issue, the court held that, since this was a claim seeking solely equitable relief, it was excluded by the policy's definition of loss as no "damages" were sought. Thus, the court concluded that there was no potential coverage for any claims against the policyholder and, as such, the insurer had no obligation to advance defense costs for claims against the company.

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