

Collateral Estoppel Does Not Apply to Coverage Issue

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In an unreported decision, the United States District Court for the Northern District of California held that collateral estoppel did not preclude it from reviewing a coverage issue that had not been "actually litigated" in the underlying suit and that had not been "necessary" to the underlying decision. *Wright v. Employers Reins. Corp.*, 2005 WL 756618 (N.D. Cal. Mar. 31, 2005).

In the underlying action, the plaintiffs filed suit against an insured company and one of its agents. The complaint alleged that the agent and others marketed promissory notes to senior citizens. The agent sought coverage under an E&O policy issued to the company. The insurer denied coverage on various grounds, including that (i) the agent was not an insured when the claim was made, (ii) the marketing of the notes was an unlicensed activity not covered under the policy and (iii) the policy did not contain a financial products endorsement or financial planner endorsement that might have provided coverage.

The agent settled with the underlying plaintiffs at an early stage of the case in exchange for payment of \$6,000 and an assignment of any claim against the insurance carrier. The plaintiffs subsequently secured a judgment for more than \$163,390. The court made findings in its judgment that the agent was acting in an insured capacity and that the claim was made during the policy period.

The plaintiffs in the underlying action, pursuant to the settlement agreement, then filed suit against the insurer alleging bad faith breach of duty to defend, bad faith breach of duty to indemnify, breach of contract, fraudulent false promises and unfair business practices. Although the plaintiffs could not dispute the insurer's grounds for denying coverage, they argued that the insurer was barred from litigating those issues because of collateral estoppel.

The court held that collateral estoppel did not apply, under California law, because the issues had not been "actually litigated" and were not "necessary to the court's finding of liability in the underlying litigation." The court found that the insurer could be bound by the underlying judgment only as to "findings of fact essential to the judgment of liability of the insured" and not to "issues not necessarily adjudicated in the prior action." The court thus held that the insurer was not bound by the parts of the underlying action relied upon by the plaintiffs for their collateral estoppel argument, and that summary judgment in favor of the insurer was therefore appropriate.

For more information, please contact us at 202.719.7130.