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Insurer's Duty to Defend Continues Until All Arguably-Covered Claims Against the Insured Have Been Extinguished With Finality

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Insights for Insurers

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Plaintiff homeowners sued defendants, a planning agency and its contractor, for damages they allegedly sustained to their home as a result of a nearby public-works construction project. Defendant insurer had issued a liability insurance policy to the contractor, which covered the agency as an additional insured, but only with respect to liability arising out of the contractor's operations. The insurer agreed to defend the contractor and the agency.

The contractor and agency each moved for summary judgment and the U.S. District Court for the District of Minnesota granted the contractor's motion and dismissed it from the case. The court denied the agency's motion and set a date for trial. The insurer then advised the agency that it was denying coverage and would withdraw the defense. Given the dismissal on summary judgment of the contractor, the insurer concluded there was no longer any possibility that the contractor could be found liable for its operations at the project and, therefore, no possibility that the agency's remaining liability arose out of the contractor's operations. However, the insurer granted the agency a 30-day grace period during which it would continue to pay the agency's reasonable defense costs. The agency and the homeowners settled the case pursuant to a *Miller-Shugart* agreement during that 30-day grace period, but it was not finalized and entered by stipulation until approximately two months later. Under Minnesota law, if an insurer has denied coverage an insured may stipulate to judgment and assign its claim against the insurer to the claimant in exchange for a promise that the claimant would only seek to enforce the judgment against the insurer. Under the terms of the *Miller-Shugart* agreement executed between the homeowners and the agency, the agency paid the homeowners $250,000, stipulated to a judgment of $900,000 and assigned its claims for indemnity and defense against the insurer to the homeowners.

The homeowners filed an action against the insurer seeking to collect the stipulated judgment of $900,000 and damages for the insurer's alleged breach of its duty to defend the agency. The court dismissed the claim for indemnity of the agency's liability because there was no evidence demonstrating that the damages arose from an "occurrence" under the policy. The homeowners and the insurer subsequently cross-moved for summary judgment on the issue of whether the insurer had breached its duty to defend the agency in the

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underlying lawsuit by withdrawing the defense.

The court rejected the insurer's argument that its duty to defend the agency had been extinguished when the contractor was dismissed from the underlying lawsuit. The court held that while an insurer can withdraw from a defense after all arguably covered claims have been extinguished, this principle applies only when all arguably covered claims have been dismissed "with finality." The dismissal of the homeowners' claim against the contractor did not terminate the insured's duty to defend the agency because that dismissal remained subject to reversal on appeal. There remained the possibility that the arguably covered claim would be reinstated and, accordingly, the duty to defend remained.

Practice Note

A liability insurer must not react too quickly in withdrawing its defense when covered claims have been dismissed against the insured. A liability insurer's duty to defend continues as long as there remains any possibility that an arguably-covered claim could be revived against the insured, including the possibility that a claim might be reinstated upon appeal.

Nelson v. American Home Assurance Co., No. 11-1161, 2011 WL 6151519 (D. Minn. Dec. 12, 2011).

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