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# LITIGATING AGAINST DISTANT INSURANCE CARRIERS

MICHAEL C. GERAGHTY\*

## INTRODUCTION

In apportioning liability between dioceses and their insurers in cases of past sexual misconduct by members of the clergy, issues often arise regarding lost or distant insurance policies. This discussion illustrates some of these issues by reviewing a case recently filed against the Diocese of Spokane, and examining three recent decisions which impact this topic.

### I. DISTANT INSURANCE CARRIERS

In December 1992, the Diocese of Spokane was named as a defendant in an action commenced by a single woman now in her late thirties. The plaintiff alleged that, from 1968 to 1973, while a parishioner at a Spokane parish and a student at a diocesan, girls high school, she was sexually abused, harassed, and intimidated by a Franciscan Brother who served both at the parish and the high school. The high school has been closed since 1979. The suit was filed against the Brother, who has not been in the Diocese since the mid-1970s, the Catholic Diocese of Spokane, the Catholic Bishop of Spokane, the Franciscan Friars Province of Santa Barbara, and, finally, the infamous Roman Catholic Church of the Papacy.

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The basis of the claim against the Diocese was negligent supervision. The complaint also alleged, against the Franciscan Brother, assault and battery, outrageous conduct, negligent or intentional infliction of emotional distress, and a claim that this conduct was ratified by the other defendants. The negligence claims triggered the Diocese's endeavor to get an insurance company involved.

The damages sought by the plaintiff were typical in a complaint of this nature: compensation for severe physical, psychological, and emotional pain, suffering, and distress; reimbursement for psychological treatment; and compensation for loss of family relationship, loss of the woman's marriage, and loss of her religious faith. Initially, the Diocese searched to determine whether it had insurance coverage from 1968 to 1973 because this was the first sexual abuse litigation in the Diocese that went back that far. The Diocese then contacted the insurance agency that had served it during that period. The account executive who handled the Diocese's insurance during the period when the sexual misconduct allegedly occurred was retired and had no recollection of which insurer the Diocese had its policy with. All of the agency records have long since been destroyed. The Diocese's archives were searched and, fortunately, established that, during a period from 1964 through the mid-70's, the Diocese was insured through General Accident, which is now Safeco Insurance Company.

There was some evidence of a comprehensive, general-liability policy for the period April 1, 1967 through February 1, 1968, which suggested \$200,000 coverage per occurrence during that period. Some correspondence with policy numbers further suggested that Safeco insured the Diocese in both 1969 and 1971. No records were found for the years 1970, 1972, and 1973. Based on this evidence, the Diocese tendered the defense to Safeco, and Safeco accepted.<sup>1</sup> Of course, Safeco reserved its rights regarding the nature and facts of the case, and whether there was an "occurrence" as defined in the policy in existence at the time.

One fortunate aspect is that, in the late 1960s and early 1970s, most insurance companies would have issued a standard, general-comprehensive liability policy form which would not have contained a specific exclusion for sexual claims or sexual misconduct, as we find in policies today. Unfortunately, the policy limits that were available then are usually well below the claims faced by insureds today.

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<sup>1</sup> Safeco assigned independent counsel to represent the Diocese and the Bishop. The case subsequently went through mediation and was settled.

## II. FIRST ENCOUNTER THEORY

Another issue concerns the "first encounter" theory.<sup>2</sup> This theory is applied to determine the exact amount of coverage available for older claims, where an insurance company that provided coverage at the time can actually be located.

## A. Interstate Fire &amp; Casualty Co. v. Archdiocese of Portland

The first case to deal with the first encounter theory is *Interstate Fire & Casualty Co. v. Archdiocese of Portland*.<sup>3</sup> In *Interstate*, a priest was accused of sexually abusing a young man from 1974 to 1985.<sup>4</sup> The parties settled for a total of \$500,000 plus defense costs.<sup>5</sup> In allocating the funds, \$50,000 came from the priest, \$74,997 was paid by the Archdiocese of Portland, \$125,000 was paid by another insurer, Lloyds, and \$346,999 was paid by Interstate.<sup>6</sup>

Interstate brought an action for declaratory judgment, seeking to recover the sums it had contributed to the settlement.<sup>7</sup> Interstate's argument was based on the structure of the Archdiocese's insurance policy.<sup>8</sup> The policy required the Archdiocese to make self-insured retention payments ("SIRs") toward any claim before Interstate was obligated to make excess payments.<sup>9</sup> Lloyd's policy provided for payments of liabilities exceeding the SIR payments, up to a maximum of \$200,000.<sup>10</sup> Interstate, liable only for coverage in excess of \$200,000, argued that the sexual en-

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<sup>2</sup> See *infra* note 14 and accompanying text (discussing application of first encounter doctrine).

<sup>3</sup> 747 F. Supp. 618 (D. Or. 1990), *rev'd*, 35 F.3d 1325 (9th Cir. 1994). The district court's decision in *Interstate* was reversed after this address was delivered at the twenty-ninth annual meeting of the National Diocesan Attorneys Association. However, as the "first encounter" issue remains undecided in many jurisdictions, this discussion is still relevant to interpreting policies in litigation against insurance carriers. See *infra* note 14 (discussing cases adopting *Interstate's* first encounter rule).

<sup>4</sup> 747 F. Supp. at 621. In 1983, the priest had plead guilty to charges of sexually abusing several children, and was subsequently sentenced to jail. *Id.* Fred Grgich, one of the alleged victims, subsequently filed the civil suit at issue in 1985, naming the Archdiocese and the priest as defendants. *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 619.

<sup>8</sup> *Id.* at 621.

<sup>9</sup> 747 F. Supp. at 619. Self-insured retention payments ("SIRs") are payments set aside to cover future liabilities, rather than covering the liabilities through insurance. BLACK'S LAW DICTIONARY 1360 (6th ed. 1990). It is common business practice to self-insure up to a certain dollar amount and to provide for excess liabilities with insurance. See C. ARTHUR WILLIAMS, JR. & RICHARD M. HEINS, RISK MANAGEMENT & INSURANCE (3d ed. 1976).

<sup>10</sup> *Interstate*, 747 F. Supp. at 620. The Archdiocese's SIRs were \$60,000 in 1978 to 1979, \$75,000 in 1979 to 1981, and \$100,000 in 1982 to 1984. *Id.* at 620 n.1. Lloyd's was obligated to pay excess liabilities up to \$200,000 during those years. *Id.* at 620.

counters between the plaintiff and the priest were considered separate occurrences.<sup>11</sup> Thus, since the Archdiocese and Lloyds would be liable for each of these encounters throughout the various years up to the limits of the SIR on the part of the Archdiocese, and up to \$200,000 on the part of Lloyds, Interstate's excess coverage would never be triggered.<sup>12</sup> Lloyds and the Archdiocese, of course, argued that there was a single occurrence that began with the first encounter between the victim and the priest, and the Archdiocese's exposure to liability ran concurrent with the alleged failure to properly supervise the priest.<sup>13</sup>

The Court agreed with the Archdiocese and Lloyds, holding that the continuous negligence of the Archdiocese in retaining and supervising the priest exposed the Archdiocese to liability, beginning with the first occurrence of sexual abuse in 1979.<sup>14</sup> Therefore, the excess carrier, Interstate, was liable under the first encounter theory for liability in excess of \$200,000.<sup>15</sup>

<sup>11</sup> *Id.* at 621.

<sup>12</sup> According to Interstate, the settlement payments should have been made as follows:

<u>Year</u>	<u>SIR Amount</u>	<u>Lloyd's Coverage</u>	<u>Interstate's Coverage</u>
1979-1980	\$75,000	\$50,000	\$0
1980-1981	\$75,000	\$50,000	\$0
1981-1982	\$100,000	\$25,000	\$0
1982-1983	\$100,000	\$25,000	\$0

*Id.* at 622. By dividing the settlement among the four policy years, the aggregate of the SIR and Lloyd's limit, \$200,000, would never be reached. Therefore, Interstate would have no obligations. *Id.*

<sup>13</sup> *Id.* at 622. Typically, an "occurrence" insurance policy indemnifies the insured for any events or occurrences which take place within the policy period, regardless of when an actual claim is made. *See, e.g.,* Appalachian Ins. Co. v. Liberty Mutual Ins. Co., 676 F.2d 56, 59 (3d Cir. 1982).

<sup>14</sup> *Interstate*, 747 F. Supp. at 624-25. As indicated in note 3, *supra*, the Ninth Circuit recently reversed the district court's decision in *Interstate*. 35 F.3d 1325, 1331 (9th Cir. 1994). The court held that the Archdiocese's liability arose from the victim's repeated exposure to the priest, constituting separate occurrences for each insurance policy period. *Id.* at 1329-31. Nevertheless, other courts have adopted the first encounter doctrine announced by the district court in *Interstate*, viewing similar instances of sexual misconduct as a continuous but single occurrence that implicated only the insurance policy covering the period of the first encounter. *See, e.g.,* Lee v. Interstate Fire & Casualty Co., 826 F. Supp. 1156, 1161-63 (D. Ill. 1993) (adopting *Interstate* view that, under similar insurance policy, actions of priest and negligence of diocese constituted one occurrence); May v. Maryland Casualty Corp., 792 F. Supp. 63, 65 (E.D. Mo. 1992) (applying *Interstate* first encounter theory under similar facts); *see also* Servants of Paraclete, Inc. v. Great Am. Ins. Co., 857 F. Supp. 822, 831-32 (noting disagreement among courts over first encounter rule).

<sup>15</sup> *Interstate*, 747 F. Supp. at 625.

B. *May v. Maryland Casualty Corp.*

A subsequent case involving the first encounter theory, *May v. Maryland Casualty Corp.*, arose from a dispute between the Archdiocese of St. Louis and two insurance carriers.<sup>16</sup> The Archdiocese had settled two claims, both which involved a basketball coach who allegedly sexually abused two students in 1982.<sup>17</sup> Since the first encounter theory, based on *Interstate*, was accepted by the parties as the applicable law,<sup>18</sup> the litigation involved which insurance company was liable for the claims against the Archdiocese. Though the carriers both disputed that the acts occurred during their respective insurance policy periods,<sup>19</sup> the court found that both policies were implicated by the incidents.<sup>20</sup>

This case is not so significant for its application of the first encounter theory because it was accepted by the parties as the governing law. The real significance involves the adverse findings against insurance companies that had not defended the Archdiocese. The Court found that the insurance companies were liable for reimbursing the Archdiocese as provided under the policies, as well as for prejudgment interest and attorneys fees.<sup>21</sup> While the two insurance companies were fighting over which was liable, neither one of them stepped in to defend, so the Archdiocese settled both cases while keeping the insurance companies fully informed during its investigation.<sup>22</sup>

Significantly, *May* establishes that, where dioceses have a reluctant insurance company, if it is believed that the company has a duty to defend, the diocese should pursue the insurer. By keeping the company fully informed during the matter, if the case is settled without the insurer defending, the Archdiocese may not be precluded from recovering the full limit of the policy plus prejudgment interest and attorneys fees.

C. *Kansas State Bank & Trust v. Midwest Mutual Insurance Co.*

A third case, *Kansas State Bank & Trust v. Midwest Mutual Insurance Co.*, adds a twist to the first encounter theory.<sup>23</sup> In *Kansas State*, a

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<sup>16</sup> 792 F. Supp. 63, 64 (E.D. Mo. 1992).

<sup>17</sup> *Id.* at 64.

<sup>18</sup> *Id.* at 65. Although the district court in *May* adopted *Interstate* prior to its reversal by the Ninth Circuit, as indicated in note 14, *supra*, other courts similarly apply the first encounter theory.

<sup>19</sup> 792 F. Supp. at 64.

<sup>20</sup> *Id.* at 67.

<sup>21</sup> *Id.* at 65-67. The court noted that an insurer has a duty to defend the insured if the complaint alleges facts which place a claim within policy coverage. *Id.* at 64 (citing *Howard v. Russell Stover Candies, Inc.*, 649 F.2d 620, 624 (8th Cir. 1981)).

<sup>22</sup> *Id.* at 67.

<sup>23</sup> 1992 WL 363680 (D. Kan. 1992), *clarified*, 1993 WL 59175 (D. Kan. 1993), *aff'd*, 25 F.3d 1057 (10th Cir. 1994).

teacher employed by the insured Church and school was accused of molesting a minor student.<sup>24</sup> The insurance company took the position that, in accordance with the first encounter theory, it should only be liable up to the limits of its policy implicated during the period of the first encounter, \$100,000.<sup>25</sup> However, the court viewed an "occurrence" as being separate for each policy period.<sup>26</sup> *Kansas State* involved policies covering three years with \$100,000 limits each year.<sup>27</sup> The court held that it would allow separate recovery for each year as long as there were occurrences during each of the three policy periods.<sup>28</sup> With this alternative to the first encounter theory, hopefully, dioceses will be able to successfully assert that incidents of abuse involve separate occurrences in order to expand coverage beyond the period of the first encounter.

#### CONCLUSION

Dioceses required to locate distant insurance policies to recover claims may encounter difficulties similar to those experienced in the Diocese of Spokane. Once policies are ascertained, though, the coverage available may depend on whether the liability is viewed as separate occurrences spanning multiple policy periods, or a single occurrence beginning with the first encounter of misconduct. Depending on the terms of the particular policy, either interpretation may help the diocese maximize the coverage it is entitled to.

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<sup>24</sup> 1992 WL 363680, at \*1.

<sup>25</sup> The insurance policy limited the insurer's liability for sexual harassment or abuse claims to \$100,000 for each occurrence. *Id.* at \*2.

<sup>26</sup> *Id.* at \*3. See *Interstate Fire & Casualty Co. v. Archdiocese of Portland*, 35 F.3d 1325, 1329-31 (9th Cir. 1994) (viewing sexual abuse of boy by priest as separate occurrences for each policy period); *Winona v. Interstate Fire & Casualty Co.*, 841 F. Supp. 894, 897-99 (D. Minn. 1992) (rejecting first encounter theory and viewing continued negligent supervision of priest as separate occurrences which triggered separate insurance policies).

<sup>27</sup> *Kansas State Bank & Trust*, 1992 WL 363680, at \*3.

<sup>28</sup> With a \$100,000 per year policy limit, the insurer was liable for a maximum of \$300,000. *Id.* at \*4.