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INSURANCE COVERAGE ISSUES IN CASES OF CLERGY MISCONDUCT

JAMES A. SERRITELLA*

INTRODUCTION

The accusations of sexual misconduct with minors on the part of Catholic clergy have had many ramifications. One of the ramifications that has come center stage involves insurance. Traditionally, diocesan insurance has been a relatively sleepy domain involving chiefly slip and fall cases, property and casualty questions, and only rarely, cases where there was serious disagreement between a diocese and its insurer. That sleepy domain has now been clearly relegated to the past.

Dioceses which experienced long term friendly relations with their insurers are being denied coverage for particular claims and sometimes even drawn into litigation on coverage issues. One cannot help but ask whether the dioceses can protect their own interests while restoring some harmony in their relations with their insurers. The answer is predicated on developing a fuller understanding of the law governing the relation between an insurer and insured, and fostering modes of conduct that would put the dioceses in a more advantageous position vis-a-vis their insurers. This paper will cover an analysis of some key concepts and current developments in the law, and include some practical suggestions.

I. INSURANCE COVERAGE GENERALLY

Before discussing insurance coverage relating to clergy misconduct specifically, it may be useful to discuss some basic concepts relating to insurance coverage generally. These concepts are central to the way that the courts have framed the issues in cases involving clergy misconduct. The first basic concept is that insurance compensates for accidental injuries or “fortuitous loss”—rather than intentional acts. As one court has stated,

* Burke, Warren, MacKay & Serritella.
"If a single insured is allowed to consciously control the risks covered by the policy, a central concept of insurance is violated."¹ This concept explains why insurance will not cover acts of clergy misconduct either directly or through vicarious liability.

As to the insurance policies themselves, liability policies either exclude coverage for conduct that is "expected or intended" or include coverage for conduct that is "unexpected and unintended." A policy might state, for instance that it provides coverage for "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured."² Thus, when courts explore whether or not a diocese should be entitled to recover for negligent hiring or supervision, a court will often question whether or not the conduct was expected or intended. Again, because insurance does not compensate for intentional acts, a policy would not compensate a diocese for results expected or intended on the part of the insured.

Another issue stemming from common policy terminology centers around the term "occurrence." Liability policies provide coverage for damages caused by "an occurrence" during the policy period, which is commonly defined as "an accident or event or continuous or repeated exposure to conditions."³ The issue of how many occurrences have resulted from a given set of facts often arises because policies may limit coverage per-occurrence or may require deductibles or self-insured retentions to be paid on a per-occurrence basis.

Another key concept in insurance that has come to the forefront in clergy misconduct cases is whether coverage under a given policy is "triggered." The basic test for determining whether coverage has been triggered first depends on the type of policy that has been issued. Liability policies may be written on a "claims made" basis or on an occurrence basis, as already described. For a "claims made" policy, it is the presentation of a claim by a third party that triggers the policy in effect at the time

¹ Diocese of Winona v. Interstate Fire & Cas. Co., 89 F.3d 1386, 1392 & n.7 (8th Cir. 1996); see also Allstate Ins. Co. v. Mauldin, 869 F. Supp. 478, 479 (W.D. Tex. 1994) (noting "courts afford coverage for fortuitous damages but deny coverage when damages are the natural and probable consequences of intentional conduct") (applying Texas law).

² Maryland Cas. Co. v. Havey, 887 F. Supp. 195, 198 (C.D. Ill. 1995) (original emphasis omitted and emphasis added). Cf Interstate Fire & Cas. Co. v. Archdiocese of Portland in Oregon, 747 F. Supp. 618, 620 (D. Or. 1990), rev'd on other grounds, 35 F.3d 1325 (9th Cir. 1994) (reciting terms of policy defining an occurrence as "an accident or a happening or event or a continuous or repeated exposure to conditions which unexpectedly and unintentionally results in personal injury, or damage to property during the policy period.") (emphasis added).

³ See e.g., Havey, 887 F. Supp. at 198 (reciting terms of policy that covers damages because of bodily injury or property damage "caused by an occurrence").
the claim is made.\textsuperscript{4}

Under an “occurrence” policy, however, coverage commonly is triggered when an injury happens during the policy period. As a general rule, the date of the occurrence “is determined by referring to the time of injury.”\textsuperscript{5}

Whether coverage is triggered, however, will ultimately depend upon the specific language of the policy, as well as the court interpreting the policy. For instance, a policy stating that coverage applies for personal injury damages arising out of occurrences happening during the policy period, may or may not be interpreted to require that the occurrence take place during the policy period. One court has called such language ambiguous and interpreted it to mean that injury must result during the policy period.\textsuperscript{6} Another court has called such language plain and found that “it is the occurrence, rather than the damages, that must ‘happen during the policy period.’”\textsuperscript{7} Thus, there is both some uncertainty in the courts’ applications of triggering rules and some room for argument in determining whether coverage under a given policy has been triggered.

With this basic foundation of some concepts that are central to insurance coverage generally, I’ll move on to discuss how such concepts affect insurance coverage in cases of clergy misconduct.

II. THEORIES OF COVERAGE IN CASES OF SEXUAL ABUSE

A. Coverage for the Abuser

1. Intentional Conduct and the Inferred-Intent Rule

As to coverage for the abuser, the caselaw in this area has developed around the central concept that insurance compensates for accidental injuries rather than intentional acts. Thus, the vast majority of courts deny abusers a defense or coverage in cases of sexual abuse of minors. The

\textsuperscript{4} See Graman v. Continental Cas. Co., 409 N.E.2d 387, 390 (Ill. App. Ct. 1980) (“It is well-established that the ‘claims made’ or ‘discovery’ policy is characterized by coverage for negligent acts or omissions only if such are discovered during and brought to the attention of the insurer within the policy term.”).

\textsuperscript{5} Michigan Chem. Corp. v. American Home Assurance Co., 728 F.2d 374, 381 (6th Cir. 1984); see also Milbank Ins. Co. v. J.T., No. C7-96-1225, 1997 WL 10525, at *2 (Minn. Ct. App. Jan. 14, 1997) (while the injury must take place during the policy period, “[t]here is no requirement that the negligent act or accident causing the injury also occur during the policy period”).


\textsuperscript{7} Archdiocese of Portland, 35 F.3d at 1329 (emphasis added).
courts have developed what has become known as the inferred-intent rule. Under the inferred-intent rule, an abuser's intent to injure his victims will be found as a matter of law. Thus, an insurer will have no duty to defend or indemnify someone who engaged in sexual abuse because the inferred intentional bodily harm will fall outside the coverage of the insurance policy.8

The inferred-intent rule stems from public policy considerations recognizing the "inherently injurious" nature of sexual abuse. One court has stated that "the alleged sexual contact is so substantially certain to result in some injury, or so inherently injurious, 'that the act is considered a criminal offense for which public policy precludes a claim of unintended consequences, that is, a claim that no harm was intended to result from the act.'"9 Ohio’s Supreme Court has determined that there is no need to even look to the "intentional acts exclusion" of a policy and has applied the inferred-intent rule to conclude that "[t]he public policy of the state of Ohio precludes issuance of insurance to provide liability coverage for injuries produced by criminal acts of sexual misconduct against a minor."10

While courts infer an abuser’s intent, and thus typically deny even a duty to defend, a policy provision may be worded in such a way as to require an insurer to defend an abuser for alleged intentional conduct even if there is no duty to indemnify. Such was the case in Maryland Casualty Co. v. Vonnahmen,11 where the Seventh Circuit found no duty to indemnify, but a duty to defend based on a policy provision which stated that the insured was protected under the policy for claims alleging sexual behavior "unless a judgment or a final adjudication adverse to the insured shall establish that such behavior occurred as an essential element of the cause of action so adjudicated."12 Such provisions, however, appear to be the exception rather than the rule. However, in jurisdictions where the issue has not been squarely decided, even without such a provision, courts may find a duty to defend based on judicial ruling that an insurer’s duty to defend is broader than the duty to indemnify. Therefore, if a complaint alleges some theory that would trigger the policy, a duty to defend may arise.

2. Negligent Conduct

Because the inferred-intent rule precludes coverage for acts of abuse,
some have sought to bring their claims within policy coverage by alleging "negligent abuse." Again, because acts of sexual abuse are viewed as intentional and inherently injurious, courts typically reject allegations of negligence against an abuser as "transparent attempt[s] to trigger insurance coverage." One court, for instance, found no duty to defend or indemnify because a claim of "negligent failure to seek or obtain treatment for pedophilia" was not independent of the alleged intentional acts of sexual molestation.

As the language of this court suggests, however, a duty to defend may be found if a complaint alleges negligent acts that are independent or distinct from the sexual abuse alleged. One court has found a duty to defend where an issue of fact existed as to whether allegations of public embarrassment were separate and apart from allegations of sexual molestation.

Although the law in this area is fairly well-settled, a decision from a federal district court in Alabama has found a duty to defend a claim for negligent touching which was subsequently added to a complaint alleging intentional acts of exposure and contact and various other intentional torts. Furthermore, a federal district court in Pennsylvania has found a duty to defend where a complaint alleged that the insureds' minor daughter sexually molested a child at the insureds' day care center. While the complaint alleged both intentional and negligent acts against the daughter, it is unclear from the facts of the opinion if this is an instance of a duty to defend "negligent" acts of abuse or if this falls within a long line of cases finding a duty to defend for acts of negligence, separate and apart from the alleged abuse.

Still, despite any aberrations, the rule remains that insurance will not compensate for intentional acts of abuse. As a result, the search for negligent acts—and insurance coverage—has led to those who hire and supervise the clergy involved. This search has brought the issue to the doorsteps of the dioceses.

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13 Havey, 887 F. Supp. at 200-01 (holding that an allegation of negligence could not "be separated from [the abuser's] alleged acts of intentional sexual assault"); see also id. at 201 (stating that no claim existed for negligent breach of the duty between clergy and their congregation, because Illinois had not recognized such a duty).


15 See Horace Mann Ins. Co. v. Barbara B., 846 P.2d 792, 797 (Cal. 1993); see also Snyder v. National Union Fire Ins. Co., 688 F. Supp. 932, 938 (S.D.N.Y. 1988) (duty to defend where complaint alleged "separate and distinct acts of medical malpractice" because genuine issues existed as to whether these acts were committed in addition to alleged acts of sexual abuse).


B. Coverage for the Dioceses

1. Negligent Hiring and Supervision

While an abuser’s intent to injure will be inferred, those who hire and supervise the alleged abuser—typically his Diocese—may be entitled to a defense and coverage for allegations of negligent hiring and supervision. Some courts find that “a refusal to distinguish between the abuser’s intentional conduct and the employer’s alleged negligence in hiring the abuser ignores the clear language... [of a policy that] excludes bodily injury or property damage expected or intended from the standpoint of the insured.”

In cases of negligence, however, one word can sometimes make the difference as to whether coverage will be found. If an intentional act exclusion provision precludes coverage when “an insured”—rather than “the insured”—intentionally causes an injury, claims based on a third party’s negligence are commonly excluded.

As explained by James K. Kloss and Carl F. Mariano:

If the intentional act exclusion refers to the acts of “the insured,” courts have uniformly considered the insurer’s obligations to several insureds to be severable rather than joint; that is, there are separate contracts with each of the insureds. The result is that an excluded act of one insured does not bar coverage for other insureds who have not engaged in the excluded conduct. If the policy excludes coverage for intentional acts of “an insured,” however, the courts have held that the intentional act of any insured bars coverage for all insureds.

Such a result demonstrates the importance of being aware of the specific language of your policy—and how the courts have interpreted such language.

Still, the conduct of a diocese in hiring and supervising an alleged abuser potentially falls within the coverage of some insurance policies. And in this context, another of the general concepts of insurance coverage becomes relevant—the concept of “expected or intended” conduct. As I

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19 See, e.g., Johnson v. Allstate Ins. Co., No. Civ. 95-151-P-H, 1996 WL 66231, at *2 (D. Me. 1996) (holding that policy language that excluded “coverage for ... [damages] ‘intentionally caused by an insured person’ ” precluded coverage for damages resulting from one insured’s negligent acts because they were the same damages caused by the insured abuser’s acts).

stated earlier, liability policies either exclude coverage for conduct that is expected or intended or include coverage for conduct that is unexpected and unintended. The issue here becomes where to draw the line between negligence and that which is expected.

2. Expected or Intended Conduct

Retaining an abuser after being informed of allegations of sexual misconduct and after a psychological evaluation of the abuser is sought may not preclude insurance coverage for a claim of negligence stemming from subsequent acts of abuse. One court has stated that such knowledge “does not necessarily ascribe to the Diocese the requisite expectation and intent to transform its retention of... [the abuser] from ordinary negligence into gross or willful negligence—which transformation might exclude the actions of the Diocese from ‘occurrence’ coverage under the general liability section of the policy.”

At some point, however, a supervisor’s action in keeping an abuser in a position to abuse will rise to the level of conduct that is expected or intended, and will fall outside the coverage of the policy. When examining whether a supervisor “expected” the victim of the abuse to be harmed, one court framed the issue as “whether a reasonably prudent person in the position of the Diocese and the Archdiocese knew or should have known that [the abuse]... was substantially probable as a result of the continuing exposure caused by their willful indifference.”

The issue is analyzed on a continuum. In other words, “[t]he difference between damages that are reasonably foreseeable and damages that are substantially probable is one of degree of expectability.” The Eighth Circuit in Diocese of Winona v. Interstate Fire & Casualty Co. offered an example to explain this idea: “[I]f an insured is alerted to a problem, its cause, and knows or should have known of the likelihood of the problem’s reoccurrence, it cannot ignore such problem and then look to its insurer to reimburse it for the liability incurred by reason of such inaction.”

While in some circumstances it may be difficult to decipher if conduct has reached the “substantially probable” point on the expectability continuum, the court in this case did not believe it was faced with such a problem. The court held that there was “overwhelming evidence” that the

22 Winona, 89 F.3d at 1391.
23 Id. at 1392.
24 89 F.3d 1386 (8th Cir. 1996).
25 Id. at 1392.
Diocese knew or should have known it was highly likely that the abuse would recur: the Diocese (i) knew that for years the priest had been abusing children in every parish in which he had served and (ii) knew that treatment was ineffective. Still, the Diocese allowed the priest to be placed in situations in which he could continue to abuse.\(^\text{26}\) Because further abuse was expected under such circumstances, coverage was denied. The court reached a similar conclusion with respect to the Archdiocese, but allowed coverage for a brief period after the Archdiocese first learned of the abuse.\(^\text{27}\) Thus, while some conduct may clearly be at the extremes of the continuum, there are no bright line rules for determining whether many scenarios constitute conduct that is “expected or intended” or “unexpected and unintended.”

In addition to being aware of the basic theories of coverage applicable to clergy who engage in misconduct and the dioceses that assign and supervise such clergy, it is useful to be aware of potential policy provisions which can affect the insurance coverage available to a diocese. Such provisions include those that exclude sexual misconduct, those that limit the coverage available in cases of sexual misconduct, and those that define the type of injury covered by a policy.

C. **Exclusions from Coverage**

First, some policies expressly exclude coverage for claims “arising out of” abuse or molestation.\(^\text{28}\) While such a policy provision will, of course, preclude any coverage for clergy committing misconduct, claims for negligent hiring, supervision or retention of the abuser are also commonly excluded as “arising from” the act of abuse.\(^\text{29}\) Such negligence claims are excluded as arising out of the abuse because the sexual abuse constitutes an essential element of such claims.\(^\text{30}\)

\(^{26}\) See id. at 1394.

\(^{27}\) See id. at 1395-96.

\(^{28}\) See, e.g., McAuliffe v. Northern Ins. Co. of N.Y., 69 F.3d 277, 279 (8th Cir. 1995) (affirming district court’s decision that the abuse and molestation exclusion precluded coverage for claims of tortious conduct against priest and claim of negligent supervision against Bishop); Hough v. State Farm Fire and Cas. Co., 481 N.W.2d 393, 397-98 (Minn. Ct. App. 1992) (finding no duty to defend because sexual abuse exclusion precluded claims of negligent counseling which were based on sexual relationship between pastor and parishioner).

\(^{29}\) See, e.g., IPCI Ltd. v. Old Republic Ins. Co., 758 F. Supp. 478, 480 (E.D. Wis. 1991) (sexual abuse exclusion precluded coverage for claims of negligent supervision against nursing facility where patient was sexually abused).

\(^{30}\) See All Am. Ins. Co. v. Burns, 971 F.2d 438, 442 (10th Cir. 1992) (sexual molestation by volunteer bus driver was an essential element of negligence claims against church and its directors).
D. Limitations on Coverage

While some policies may exclude coverage for claims arising out of abuse or molestation, other policies may simply set lower limits of coverage for claims involving sexual misconduct. One such “Sexual Misconduct” provision included a cap on liability for psychotherapists at $25,000 for “all claims against any Insured(s) involving any actual or alleged erotic physical contact, or attempt thereat [sic] or proposal thereof by the insured with his or her former or current patient.”31 The cap also applied to other claims of misconduct arising out of the same professional relationship if sexual misconduct was alleged.32

While the Seventh Circuit rejected arguments that such a provision violated public policy,33 the Ninth Circuit has affirmed a decision finding the provision void as against public policy to the extent that it caps liability on non-sexual misconduct claims when sexual misconduct claims are also involved.34

E. Types of Injuries Covered

In addition to policy provisions which exclude or limit coverage for sexual misconduct, a diocese should be aware that the type of injury that a policy actually covers will also be narrowly defined. When a policy covers damages resulting from “bodily injury,” courts commonly require actual physical injury, rather than mental or emotional injury.35 Thus, a complaint alleging solely humiliation or embarrassment and no physical injury may not even bring the claim within the coverage of the policy.

However, in Servants of the Paraclete, Inc. v. Great American Insurance Co.,36 the court stated that psychological and emotional injuries such as depression, anxiety, poor self-esteem, and self-destructive behavior may constitute “sickness” under a policy defining bodily injury as “bodily in-

31 American Home Assurance Co. v. Stone, 61 F.3d 1321, 1323 (7th Cir. 1995).
32 See id.
33 Id. at 1328 (noting that the provision was approved by the Illinois Department of Insurance).
jury, sickness or disease.” Finally, it has also been held that a policy pro-
vided coverage for current bodily injuries which resulted from abuse that
had taken place years before. These cases demonstrate the importance of
a policyholder’s awareness of the specific provisions contained in the pol-
icy as they relate to a claim arising from clergy misconduct. Moreover,
one must keep in mind the importance of knowing how the relevant juris-
diction has interpreted such provisions.

III. THE NUMBER OF POLICIES TRIGGERED AND THE NUMBER OF
OCCURRENCES

In addition to the basic theories of coverage, the issues of (i) the
number of policies triggered and (ii) the number of occurrences involved
in a given case have received a great deal of attention in the area of sexual
misconduct. A brief analysis of the practical concerns at issue will facili-
tate a discussion of the cases focusing on these concepts.

A. The Issues

Cases of sexual misconduct frequently involve multiple acts of abuse
spanning several years and several policy terms. Thus, courts must deter-
mine how many separate policy terms and how many “occurrences” are
implicated.

The number of policies triggered can significantly affect the financial
burdens in a given case. If only the policy in effect at the time of the first
act of abuse is called on to respond for the damages, the insured and the
primary insurer will generally fare better—assuming there is sufficient ex-
cess coverage available. In such a scenario, the excess insurer will likely
be responsible for a large portion of the damages once the deductible is
paid and the primary insurance is exhausted. However, if several policies
are made to respond, the insured and the primary insurer may be responsi-
ble for any deductibles and coverage limits in each triggered policy period.
In this situation, the limits of the primary coverage in each policy term
may not be exhausted, and thus leave the excess insurer with no financial
responsibility whatsoever.

The number of occurrences determined also bears on the financial re-
sponsibilities of the parties. A policy may set limits on a per-occurrence
basis or may require the insured to pay a deductible or self-insured reten-
tion for each occurrence. It is typically in the interest of the excess insurer

1997) (finding that the time of “occurrence” is not necessarily when the act was committed, but
rather when the individual was actually damaged).
that several occurrences are found so that the insured is responsible for several deductibles.

Although whether a policy is triggered and the number of occurrences that result from a given set of facts are two separate concepts, the courts sometimes blur the issues, making it difficult to decipher the precise views of the court on either front. Still, a discussion of some of the cases involving these issues is useful as these issues have extreme consequences as to the financial responsibility of the dioceses.

B. The First Encounter Rule

I will begin by discussing the First Encounter Rule. As the name suggests, under the First Encounter Rule the policy in effect at the time of the first act of abuse provides coverage for all damages resulting from the abuse. This is so despite the fact that the acts of abuse may span several years and several policy terms. This position was advocated primarily by Lloyd’s, which typically issues first layer policies to dioceses. This position may also be beneficial to dioceses, depending on the situation.

The court in *Interstate Fire & Casualty Co. v. Archdiocese of Portland in Oregon* applied what has become known as the “first encounter rule” to determine which policies had been triggered. Before discussing the triggering issue, however, the court examined the number of occurrences implicated in the case.

Applying the “cause theory,” the court examined whether the negligent supervision and failure to remove arising from sexual abuse that had spanned almost four years and four policies constituted more than one occurrence. Under the cause theory, the issue is “whether there was one proximate, uninterrupted and continuing cause which resulted in all of the injuries and damage for which the claimant seeks coverage.” The court concluded that the Archdiocese’s act in hiring and failing to properly supervise or remove the abuser, although “present in each of the policy years at issue” resulted in one continuous act of negligence. This continuous act of negligence constituted the “single proximate cause” resulting in the child’s injury and was thus a “single occurrence” under the terms of the policies at issue.

As to whether coverage under a given policy had been triggered, the court determined that the injury resulting from the occurrence had to take

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38 747 F. Supp. 618 (D. Or. 1990), rev’d, 35 F.3d 1325 (9th Cir. 1994).
39 Id. at 622-23.
40 Id. at 625.
41 Id.
place during the policy term.\textsuperscript{42} Because the parties agreed that the injury had taken place at the time the child was first molested, the court determined that only the policy in effect at the time of this "first encounter" provided coverage.\textsuperscript{43}

Following the decision in Archdiocese of Portland, other courts adopted its reasoning. The court in Lee v. Interstate Fire & Casualty Co.,\textsuperscript{44} for instance, concluded that although the abuse in that case spanned two policy periods, the continuous abuse by the priest and the continuous negligence of the Diocese "were the cause of [the child's] injuries and thus constitute[d] one occurrence."\textsuperscript{45} As a result of the decision in Lee, the insured and the primary insurer were only responsible for one self-insured retention or deductible.

Subsequent history of the district court decision in Lee provides a good example of how a state's law on allocation of liability among insurers may affect an outcome in a practical sense. On a motion for reconsideration, Interstate argued that Illinois law should have applied and would have required the primary insurer to pay two deductibles, one for each policy period during which the child was injured.\textsuperscript{46} While maintaining that Illinois law did not apply to the case, the court determined that even under Illinois law, Interstate would have only been entitled to one deductible. The court reasoned that Illinois law provided for joint and several liability among insurers whose policies had been triggered, but did not necessarily require a deductible to be paid for each of the multiple policies triggered. Rather, if an insured only looked to one of the policies to cover the damages, only one deductible would apply.\textsuperscript{47} Thus, as a practical matter, the outcome of the case would not be affected.

\section*{C. Rejection of the First Encounter Rule}

As federal district court decisions applying the first encounter rule have reached the circuit courts, some circuit courts have specifically rejected the rule. The Fifth and Ninth Circuits, for instance, have each reversed decisions applying the first encounter rule, finding an occurrence in each policy term in which a victim is abused. The result of the courts' decisions is that multiple policies are triggered, rather than just the policy in effect at the time of the first encounter. The Fifth and Ninth Circuit's de-

\begin{itemize}
\item \textsuperscript{42} See id.
\item \textsuperscript{43} See id. (rejecting insurance provider's claim for reimbursement).
\item \textsuperscript{44} 826 F. Supp. 1156 (N.D. Ill. 1993), \textit{rev'd}, 86 F.3d 101 (7th Cir. 1996).
\item \textsuperscript{45} Id. at 1163.
\item \textsuperscript{46} See Lee v. Interstate Fire & Cas. Co., No. 91-C-1732, 1993 WL 558741, \textit{*1} (N.D. Ill. Jan. 6, 1994).
\item \textsuperscript{47} See id. at \textit{*2}.
\end{itemize}
decisions have focused on the language of the policies at issue as well as the number of victims and policy terms implicated in each case.

1. The Fifth Circuit

The Fifth Circuit, in *Society of the Roman Catholic Church of the Diocese of Lafayette and Lake Charles, Inc. v. Interstate Fire & Casualty Co.*, specifically rejected the first encounter rule for three reasons: (i) the court reasoned that the rule ignored the fact that the policies excluded coverage for bodily injury occurring outside of the policy period; (ii) the court believed, on the facts of the case, that the rule "would prevent insurance companies from limiting their coverage to damages emanating from molestations taking place during their policy period"; and (iii) the court found the rule inequitable in that it would exclude from coverage one who had been abused just before the Diocese obtained coverage, but who continued to be abused during the policy period.

The court applied the "exposure rule" to determine that each initial act of abuse during a new policy term constituted an occurrence triggering coverage. The court stated:

> When a priest molested a child during a policy year, there was both bodily injury and an occurrence, triggering policy coverage. All further molestations of that child during the policy period arose out of the same occurrence. When the priest molested the same child during the succeeding policy year, again there was both bodily injury and an occurrence. Thus, each child suffered an "occurrence" in each policy period in which he was molested.

The effect of the court’s analysis was that multiple policies, rather than one policy, provided coverage for the damages stemming from years of abuse.

In addition to finding that there was an occurrence in each policy period in which a child was molested, the court determined that the damage to each of the thirty-one children who had been abused constituted a separate occurrence. A district court in New York, on the other hand, has found that there was only one occurrence per policy period for a group of children who suffered "exposure to conditions of sexual abuse."

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48 26 F.3d 1359 (5th Cir. 1994).
49 *Id.* at 1366.
50 *See id.*
51 *Id.* at 1365.
52 *See id.* at 1364.
2. The Ninth Circuit

The Ninth Circuit, in *Interstate Fire & Casualty Co. v. Archdiocese of Portland in Oregon*,\(^{54}\) reversed the district court decision, finding only one occurrence and only one policy triggered. The court held that there had been four occurrences—one in each policy period. The court stated:

> [B]ecause each policy covers only damages stemming from [the child's] exposure to the [priest] occurring during the policy period, and because the parties do not contest that [the child] was exposed to the negligently supervised priest in each of the four policy periods, we conclude that [the] claim implicates four occurrences.\(^{55}\)

Specifically, the court found that based on the policy definition of occurrence, “the repeated ‘exposure’ of the boy to the negligently supervised priest,” rather than the negligent supervision alone, resulted in injury.\(^{56}\) Furthermore, the court found it significant that the policy only covered injuries arising from occurrences “happening during the period of insurance.”\(^{57}\) Thus, although the injuries all stemmed from the same general conditions, based on the facts of the case, the boy’s “exposure to the negligently supervised priest in each of the four different policy periods constituted a separate occurrence.”\(^{58}\)

As in the Fifth Circuit decision, the effect of the court’s analysis was that multiple policies provided coverage, rather than just the policy in effect at the time of the first encounter.

3. The Seventh Circuit’s Fact Specific Approach

A recent decision in the Seventh Circuit, although involving a district court decision applying the first encounter rule, takes a different approach than that of the Fifth and Ninth Circuits. The Seventh Circuit opinion suggests that decisions concerning the number of occurrences should be tied to the specific facts surrounding the negligence at issue in a given case.

In *Lee v. Interstate Fire & Casualty Co.*,\(^{59}\) the Seventh Circuit reversed the district court’s determination that the Diocese’s continuous negligent supervision, spanning two policy periods, constituted one occurrence. Applying Rhode Island law, the court declined to follow what it deemed the Fifth and Ninth Circuits’ assumption: that “every child abuse

\(^{54}\) 35 F.3d 1325 (9th Cir. 1994).
\(^{55}\) Id. at 1331.
\(^{56}\) Id. at 1329.
\(^{57}\) Id.
\(^{58}\) Id. at 1330; see also Roman Catholic Diocese of Lafayette v. Interstate Fire & Cas. Co., 26 F.3d 1359, 1363-64 (5th Cir. 1994) (reaching a similar conclusion on almost identical facts).
\(^{59}\) 86 F.3d 101 (7th Cir. 1996).
case produces either one ‘occurrence’ or many, according to the number of victims and policy years involved.”

Rather, the court determined that whether there was one or multiple occurrences was tied to the specific facts concerning the negligence alleged in each case. The court offered this example:

If as in the Portland case a diocese receives multiple warnings about a priest’s misconduct and ignores all of them, it would be appropriate to call those lapses multiple occurrences—intervention after any one of them could have avoided some of the injury. But if instead the diocese receives no danger signals, and its negligence lies in failure to investigate on its own (if that is negligence at all), or if the diocese intervenes but takes action that in retrospect is inadequate, then the lapse looks more like a single occurrence under the policy’s definition.61

Because the party bearing the burden of persuasion and production in Lee had not informed the court of the specific facts concerning the negligent supervision in the case, and “[b]ecause Rhode Island would not [have] treat[ed] negligent supervision as invariably one ‘occurrence,’ ” the court reversed the district court’s determination.62

It is not yet clear how these alternatives to the first encounter rule will fare over time, either in the misconduct area or in other areas.

D. Self-Insured Retentions

As with the number of policies triggered and the number of occurrences, courts’ decisions concerning the responsibility for self-insured retentions in each triggered policy period can significantly alter the parties’ financial responsibilities for damages. Suppose a case involving five years of abuse is settled for $500,000 and that the Diocese has five one-year policies, each with a $100,000 self-insured retention. The court’s decision on this issue will determine whether the Diocese is responsible for 1/5 of the claim or the entire claim.

Under the current trend, the Diocese in this scenario would be responsible for the entire claim. In Diocese of Winona v. Interstate Fire & Casualty Co.,63 for instance, the court held that the insured churches were responsible for the self-insured retention for “each of the triggered policies.”64 Although the court previously had determined that the

60 Id. at 104 (construing Roman Catholic Diocese of Lafayette, 26 F.3d at 1359, and Interstate Fire & Cas. Co. v. Archdiocese of Portland, 35 F.3d 1325 (9th Cir. 1994)).
61 Id. at 104-05.
62 Id. at 105 (emphasis in original).
63 916 F. Supp. 923 (D. Minn. 1995), modified, 89 F.3d 1386 (8th Cir. 1996).
64 See id. at 929.
churches were liable only for a single, weighted self-insured retention, it changed its decision in light of an intervening decision of the Minnesota Supreme Court. The court in *Winona* concluded that its case was “factually indistinguishable” from the state court case, stating:

Each litigation involved indemnification under [comprehensive general liability] policies that contained a layer of self-insurance (the SIR) for which the insured was responsible. Each involved injuries incurred over an extended period of time, a period during which the insured was covered by a number of distinct insuring agreements. And, each involved damages that could not rationally be allocated to specific policy periods in which the damages actually occurred.

The Ninth Circuit has rejected a public policy argument concerning the payment of a self-insured retention for every triggered policy. In *Interstate Fire & Casualty Co. v. Archdiocese of Portland in Oregon*, the Archdiocese argued that a finding that abuse constituted more than one occurrence would be contrary to public policy because “such a finding would require the Archdiocese to pay more than one [self-insured retention].” The court in *Portland* did not reach the issue of how damages should be apportioned among the four insurance policies triggered in the case, but still rejected the argument: although the Archdiocese may have to bear a significant burden of the settlement, such a result was “dictated by the terms of the policies the Archdiocese purchased.”

Thus, for a diocese to understand the extent of its potential liability, it is necessary to understand the courts’ interpretations of these issues concerning triggering, occurrences, and self-insured retentions. The first encounter rule is at least fairly clear and certain in its applications. The alternatives appear neither clear, nor certain. To avoid this ambiguity and its possible adverse consequences, I suggest that dioceses seek broad compensating insurance contract provisions such as larger aggregate coverage limits.

IV. COVERAGE LITIGATION

Having discussed the specific issues that frequently arise in cases involving clergy misconduct, I would like to return to some general concerns involving issues of coverage litigation that arise when insurers have im-

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65 *Id.* at 926 (relying upon *Northern States Power Co. v. Fidelity & Cas. Co. of N.Y.*, 523 N.W.2d 657 (Minn. 1994), which involved continuous environmental contamination).
66 *Id.* at 928.
67 *Id.*
68 *Archdiocese of Portland*, 35 F.3d at 1331.
69 *Id.*
properly refused to defend or provide coverage. While it is, of course, in all parties' interests to avoid such disputes, the dioceses must be aware of such possibilities in order to fully protect their rights under their policies.

A. Bases for Actions Against Insurers

Actions against insurers may be based on theories of breach of contract, wrongful failure to settle, or bad faith in refusing to defend or provide coverage. Each cause of action carries its respective burden of proof. Also highly relevant, of course, are the types of damages available to a diocese should it pursue and succeed in an action.

1. Breach of Contract

Under a theory of breach of contract in a coverage trial, the policyholder bears the burden of establishing a prima facie case. This can be done by proving that the claims fall within the operative language of the policy, namely, that the claims fall within the policy period, the identity of the insured, and the definitions of occurrence and bodily injury. Once a prima facie case of coverage has been made, the insurer bears the burden of proving the applicability of exclusions. Such exclusions might include an intentional acts exclusion or a provision that specifically excludes acts arising out of claims of sexual abuse. Some courts impose heightened standards on an insurer attempting to prove that an exclusion applies.

In a breach of contract action, the damages awarded are intended to make the policyholder whole - what the policy would have paid had the claim not been denied. When an insurer unjustly refuses to defend, an insured is entitled to recover the reasonable costs and attorneys' fees that the insured expended in its defense. Furthermore, an insured may be able to recover consequential damages. Such damages may be recovered, for example, for damage to an insured's credit rating or interest on a loan needed to pay for defending the suit.

If a policyholder can prove that the insurer breached its contractual duty to defend the policyholder against a third party's claim, then in a minority of jurisdictions most notably in Illinois the court would hold that the insurance company is estopped to deny coverage. The rationale is that if

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70 See ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES, § 9.01 (3d ed. 1995).
72 See WINDT, supra note 70, at § 4.33.
73 See id. at § 4.34.
74 See Joslyn Mfg. Co. v. Liberty Mut. Ins. Co., 23 F.3d 1212, 1214 (7th Cir. 1994) (applying Illinois law in holding that insurer was estopped in denying coverage because it breached its duty to defend).
the insurer breached its contract, the insurer should not be allowed to invoke its terms.

2. Failure to Settle

In a failure to settle a case, the policyholder has the burden of proving that the claim was potentially within coverage and may have the burden of proving that there was an opportunity to settle. Furthermore, if a policyholder wants to recover consequential damages, the policyholder may have to prove that it was possible to settle within the policy limits. If the policyholder settles the claim after the insurer denies coverage, the policyholder may have the burden of proving that the amount of the settlement is reasonable. Finally, if the policyholder seeks to recover the full amount of a judgment, the policyholder may have the burden of proving bad faith on the part of the insurer.

In the failure to settle context, where the policyholder’s liability is reasonably clear, and the insurer nevertheless rejects an opportunity to settle the claim within its policy limits, the insurer can be liable for the full amount of any subsequent judgment rendered against the policyholder. Some jurisdictions, however, require the policyholder to demonstrate that the insurer acted in bad faith before such damages will be imposed. One court has articulated the bad faith standard as the “furtherance of the insurer’s interest with intentional disregard of the financial interest of the insured.”

3. Bad Faith

As for a bad faith action, the policyholder bears the burden of proving that the insurer’s denial of coverage was so clearly unsupported by the relevant facts or policy language as to amount to a reckless breach of duty to the policyholder. Furthermore, when the insurer has acted in bad faith, in many states it is possible to recover punitive damages. To warrant such an award, the insurer’s conduct must be “tantamount to malice, oppression, or fraud” or

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75 See WINDT, supra note 70, at § 5.02.
78 See id.
79 See id. at §5.12.
81 See WINDT, supra note 70, at § 9.26 (citing First Marine Ins. Co. v. Booth, 876 S.W.2d 255, 257 (Ark. 1994)).
in "conscious disregard of the insured's rights." In Illinois, however, some question exists as to whether such damages are recoverable: section 155 of the Insurance Code puts a $25,000 cap on penalties against an insurer for a "vexatious and unreasonable" delay in paying a claim.

B. Defensive Strategies

While a diocese may initiate a coverage action, it may also find itself defending an action in which an insurer seeks a declaration as to its duties under a given policy. Thus, I will briefly discuss some possible defensive strategies which, subject to state law, a diocese might consider should it find itself on the other end of coverage litigation.

If an insurer brings a declaratory judgment action to determine whether it has a duty to defend and a duty to indemnify, a court may be willing to stay the action as to the duty to indemnify. The court in Nationwide Mutual Fire Co. v. Shank, for example, exercised its discretion to stay a determination on the issue of coverage pending the determination of facts in the underlying state court action. Relying in part on the Third Circuit's decision in Terra Nova Insurance Co. Ltd. v. 900 Bar, Inc., the court in Shank expressed its concern that the parties would be collaterally estopped on issues in the underlying action if it ruled on the duty to indemnify because the issue of intent was central to both actions. The court concluded that it should stay its decision on the issue of coverage to avoid prejudicing the parties in the underlying action.

Thus, if a diocese which has a duty to defend policy is faced with an insurer's declaratory judgment action on a duty to defend and a duty to indemnify, it should seek to have the action stayed as to the duty to indemnify pending the outcome of the underlying action. This will preserve any duty to defend that the insurer is determined to have and will avoid prejudice to the diocese in the underlying action due to the possible collateral estoppel effect of any determination in the coverage action regarding whether the diocese's conduct was expected or intended.

By this same logic, if a diocese has a duty to indemnify policy which reimburses damages and defense costs as elements of ultimate net loss, arguably, a declaratory judgment prior to the termination of the underlying action is always premature, due to the concerns regarding collateral estop-

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82 Id. (citing Aetna Cas. and Surety Co. v. Joseph, 769 S.W.2d 603, 607 (Tex. Ct. App. 1989)).
85 887 F.2d 1213 (3d Cir. 1989).
86 See Shank, 951 F. Supp. at 72-73.
pel just mentioned.

V. PURCHASING INSURANCE

Just as being informed about applicable policy provisions in the midst of litigation is important, when looking to purchase insurance it is essential to be informed about the array of provisions that may be included in a policy.

As demonstrated earlier, policy language and courts’ interpretations of such language will ultimately determine whether a diocese is left to pay a small portion of any damages or the entire claim. Thus, a diocese should be aware of these potential policy provisions and considerations bearing on the purchase of insurance. While the list I will provide is nonexhaustive, it highlights many of the important issues already mentioned, and includes some other tips central to purchasing insurance.

When purchasing insurance, first and foremost, a diocese should be certain that it is dealing with a knowledgeable broker who is sensitive to its special needs and committed to providing it with first rate service. Furthermore, the broker should have sufficient contacts to provide a diocese with the best possible deal. Initially and from time to time afterward, a diocese should put its book of business up for bids.

A. Intentional Act Exclusions

As to specific policy provisions, a diocese should be aware of the wording of the Intentional Act Exclusion of a given policy. Coverage will typically be provided if the exclusion concerns intentional acts of “the insured” rather than “an insured” or “any insured.”

B. Sexual Misconduct Exclusions

Next, a policy may contain a sexual misconduct exclusion. Under such a provision, coverage is typically excluded as arising from sexual misconduct. As stated earlier, claims against a diocese for negligent hiring or supervision are commonly excluded under such provisions because the sexual abuse constitutes an essential element of such claims.

C. Duty to Defend Provisions

While it is of course desirable to avoid sexual misconduct exclusions, an insured may not be able to avoid provisions concerning sexual misconduct altogether. A diocese may consider negotiating for a provision pro-

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87 See discussion supra Part II.C.
88 See id.
viding a duty to defend up until the time that a judgment or final adjudication is reached concerning a claim for which the sexual misconduct is an essential element.\textsuperscript{89}

D. Sexual Misconduct Caps

A diocese's insurance coverage could also be significantly affected by a sexual misconduct cap provision. Such a provision may cap at a certain dollar amount claims involving sexual misconduct. Furthermore, coverage may be capped for claims involving non-sexual misconduct where sexual misconduct is alleged.\textsuperscript{90}

E. Self-insured Retentions

As intimated earlier, policy language and courts' interpretations concerning self-insured retentions can also significantly affect a diocese's insurance coverage. If possible, a diocese should negotiate policy language limiting the number of self-insured retentions applicable to third party claims spanning multiple coverage years. If not possible, a diocese may consider augmenting its aggregate coverage, if available, lowering its self-insured retention, or obtaining separate first-dollar coverage for misconduct.

F. Notice Provisions

A diocese should also be aware of any policy notice provisions. Whether or not a diocese gives its insurer proper notice of a claim may determine whether the diocese is entitled to any recovery at all. A diocese may try to negotiate policy language which clearly defines when the diocese is charged with sufficient knowledge of a potential claim to trigger its notice obligations. Special attention should be paid if language such as "immediately" or "as a condition precedent" are included in the notice provisions as opposed to "as soon as practical" or "when it becomes reasonably likely."

G. Control of the Defenses

A provision concerning the control of the defense is also beneficial. A diocese should try to retain the power to select defense counsel and to control the defense and settlement of claims, rather than completely relinquishing such rights to its insurer.

\textsuperscript{89} See discussion \textit{supra} Part III.A.1.c.

\textsuperscript{90} See discussion \textit{supra} Part III.D.
H. Claims-made Coverage

Finally, whether the policy being considered for purchase is an occurrence based policy or a claims-made policy can determine the issues to which the diocese should be alerted. Specifically, when obtaining a claims made policy, special attention should be paid to policy provisions relating to the retroactive date and the extended reporting option. Proper language can avoid future gaps in coverage.

Though not an exhaustive list, these are many of the issues with which a diocese should be concerned when shopping for insurance. But a diocese should also be aware that some of the suggestions noted may increase the cost of coverage. Others may simply not be available under current market conditions. A diocese may test the market by sponsoring competitive bids between brokers. Such competition typically maximizes a diocese’s market exposure, thus yielding substantial premium savings.

Although a diocese should be aware of the process I have just described in order to make an informed decision to provide for its insurance needs, alternatives to this process do exist.

VI. ALTERNATIVES TO COMMERCIAL MARKET INSURANCE

Indeed, several religious organizations have found it advantageous to avoid the commercial market altogether and obtain coverage for clergy misconduct by making their own insurance arrangements. Such arrangements can take three forms, that of a risk retention group, a captive or a charitable risk pool.

A. Risk Retention Groups

The first alternative is a risk retention group. Under the 1986 revisions to the Federal Liability Risk Retention Act, associations of entities engaged in similar activities may form insurance companies to cover risks arising from those activities. Under the Act, if the risk retention group is licensed in one state, federal law preempts any other state from requiring that the risk retention group be licensed. Most risk retention groups are domiciled in Vermont which is sympathetic to the needs of risk retention groups and imposes fewer capital surplus and investment requirements upon them. Thus, several dioceses could join together (as other organizations have) to form Vermont domiciled risk retention groups.

B. Captives

Another alternative is to organize a captive, which is a concept very similar to a risk retention group.\textsuperscript{93} Usually these are domiciled off-shore, chiefly in Bermuda or the Caymans.\textsuperscript{94} The financial regulations and the tax laws in these jurisdictions are less stringent than in virtually all of the United States.\textsuperscript{95} Recent amendments to the Internal Revenue Code, however, make it less advantageous for associations of non-profit organizations to form off-shore captives. It is now easier for the IRS to claim that funds generated by these arrangements are subject to the Unrelated Business Income Tax ("UBIT"). Certain advantages remain if a single non-profit organization forms an off-shore captive. It is also common for United States domiciled captives or risk retention groups to cede reinsurance risks to related off-shore captives. Reinsuring off-shore yields the following advantage: the federal excise tax on direct insurance premiums is 4\%, whereas the federal excise tax for reinsurance premiums is only 1\%.\textsuperscript{96} In recent years, Vermont has grown to have nearly as many captives as Bermuda, and also offers some financial and regulatory benefits.

C. Charitable Risk Pools

Finally, a diocese may consider a charitable risk pool as an alternative to the commercial market. The Internal Revenue Code, again, provides advantageous treatment for charitable pooling arrangements. To benefit from this advantageous treatment, however, the risk pool must be established and licensed by a state and not all states allow such organizations.

A diocese will need to consider all of these suggestions to know which type of insurance coverage is right for its situation. But I believe a diocese will find that the time it invests in this process is time well spent. Being fully informed when purchasing insurance or entering into an alternative insurance arrangement will only benefit the diocese when it comes time to deal with a specific claim.

**CONCLUSION**

The foregoing discussion suggests practical measures a diocese (or, where applicable, a diocesan attorney) should consider to foster a more advantageous position and restore harmony to its relation with its insurer. These practical measures are rooted in the day to day relations between

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\textsuperscript{94} See id. at 133.

\textsuperscript{95} See id. at 131.

\textsuperscript{96} See 26 U.S.C. § 4371(3) (West 1997).
dioceses and the insurers:

1. The person purchasing insurance may benefit from the advice of a knowledgeable lawyer or other consultant in the purchasing and shaping the diocese's insurance plan. The better you understand what you are buying, the easier it will be to comply with insurers' requirements and the more you will be able to maximize the benefits you derive. Critically, neither the diocese nor the diocesan attorney should rely on or defer to anyone the responsibility of understanding the insurance plan and all its ramifications. The devil is in the details and knowledge of the details is central to achieving acceptable results.

2. The person purchasing insurance may wish to consider joining with other dioceses in the province, in the region, or elsewhere and pool insurance programs. There are a number of ways for doing this as well as examples of what can be done. The key is that someone has to take the initiative and begin the conversation.

3. Carefully comply with the requirements of your insurance plan. This usually means giving prompt written notice of incidents which are likely to result in claims and keep the insurer fully informed about the progress of the matter.

4. Meticulously keep a record of your communications with your insurer. This begins with your first notice to the insurer and should continue through the time the matter is closed. Depending on your circumstances, you may want to keep a separate file on your communications with the insurer for each case. This will enable you to see more readily what you have communicated to the insurer and remedy any deficiencies before they become an issue.

5. You may wish to supplement your written reports to the insurer with periodic meetings to make sure that files and facts do not fall between the cracks.

6. Whatever you do, be mindful of the possibility that you may end up in litigation with the insurer. Also, remember that good communication with an insurer is more likely to produce a good result than poor communication; and a good result obviates the need for litigation. Critically, as with other disagreements, there are more alternatives to be evaluated than just litigation. A diocesan insurance position that may have weaknesses may be more useful for negotiating a tolerable settlement with an insurer than forming the basis for litigation that the diocese has an articulable basis for losing. In other words, here as elsewhere, better a half a loaf and no legal precedent than no loaf at all and a bad legal precedent.

In the end, there is nothing magical about insurance and nothing mystical about dealing with insurers effectively. They are key players on
the liability field. In the best situations, they are on the diocesan team and function as team members. In the worst situations, they may assume a difficult posture, and the diocese may have to resort to its legal alternatives. As with other things, most relationships fall somewhere in between. This means that dioceses and diocesan attorneys must engage in an often tedious day in and day out effort to promote good relations in the hope of inspiring a cooperative response.