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NEWSLETTER

Insured's Stipulation of Liability Does Not Preclude Application of Policy Exclusion

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An Arizona intermediate appellate court, applying Arizona law, has granted summary judgment to the state's guaranty fund, holding that the fund could validly assert a coverage defense in a declaratory relief action based upon a specific policy exclusion and that it was not trying improperly to re-litigate the liability of the insured, to which the insured had stipulated in a settlement agreement. *Arizona Prop. & Cas. Ins. Guaranty Fund v. Martin*, 2005 WL 1415560 (Ariz. Ct. App. June 17, 2005).

An insurer, now insolvent, issued a professional liability policy to a chiropractic clinic. The policy provided that coverage was excluded for "injury or damage to . . . your employee . . . arising out of the course of his or her work." A clinic employee who alleged personal injury from chiropractic adjustments made during her employment sued the clinic and two of its doctors. The clinic and employee executed a "*Morris* agreement" under which the insured clinic stipulated to a judgment and assigned its rights against the insurer to the employee.

The state guaranty fund filed this action seeking a declaration that coverage for the employee's claims was excluded under the policy because her injuries occurred during the course of her employment. The trial court granted summary judgment to the insurer. The employee appealed, contending that the insurer was improperly litigating "an issue completely subsumed under the terms of . . . the *Morris* agreement," the tort liability of the insured, under "the guise of a coverage defense." The employee contended that her status as an employee "cannot be litigated, or raised as a defense to coverage, in this DRA [declaratory relief action] because it is a liability question subsumed in the underlying tort action."

In rejecting the employee's assertion, the court differentiated two Arizona court cases: *Associated Aviation Underwriters v. Wood*, 209 Ariz. 137, 98 P.3d 572 (Ariz. Ct. App. 2004) (AAU) and *United Services Automobile Association v. Morris*, 154 Ariz. 113, 741 P.2d 246 (Ariz. 1987). In *AAU*, an insurer's argument that there was no coverage because there was no insured event was rejected because "the purported coverage issue the insurer sought to litigate—the existence of actionable fault—was 'completely subsumed in the consent judgment.'" Conversely, in *Morris*, where the insureds had stipulated that their conduct was "either negligent or intentional," the court held that the insurer could litigate the conduct of the insureds because the coverage issue was "clearly unresolved" and "an insured's settlement agreement should not be used to obtain coverage that the insured did not purchase."

The intermediate appellate court concluded that the facts before it more closely resembled *Morris*, agreeing with the fund that *AAU* does not "prohibit insurers from litigating legitimate coverage issues in a DRA based upon specific policy exclusions." Citing to the fund's brief, the court added that the fund "is not arguing that there is no coverage because there is no liability. It is arguing there is no coverage because specific policy exclusions apply." In reaching this conclusion, the court rejected the employee's implicit argument that the insurer could only avoid its indemnification obligations by litigating the insured's liability in the underlying case. Instead, the court found there to be nothing "unauthorized nor unusual" by the filing of a declaratory judgment action where it had provided a defense under a reservation of rights and the insured had stipulated to its liability under a *Morris* agreement.

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