THE CHEVRON COVERAGE LITIGATION AND THE APPLICATION OF INTENTIONAL-ACTS AND PROFESSIONAL-SERVICES EXCLUSIONS IN COMMERCIAL LINES INSURANCE CLAIMS

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In the wake of the global financial crisis, an increasing number of corporate fraud suits are resulting in insurance coverage disputes as corporate executives seek to transfer risk to insurers under directors & officers, errors & omissions, and general liability lines of coverage. Insurers face coverage litigation in jurisdictions that have not been traditional venues for corporate insurance cases, sometimes having to contend with immature or poorly developed case law. One recent example is the Colorado coverage litigation resulting from the Ecuadorian Chevron Environmental Litigation and the New York fraud case that followed.

This litigation began long ago in the Ecuadorian rainforest over allegations that Chevron was liable for the contamination of millions of acres of Ecuador's Oriente region. A group of Ecuadorian plaintiffs and their U.S. lawyers sued Chevron in a Lago Agrio court and ultimately obtained an $18 billion judgment. The plaintiffs sought to domesticate the judgment in the United States and other jurisdictions where Chevron had significant assets.

Chevron brought suit in New York against the U.S. plaintiffs' lawyers and their alleged "co-conspirators" for fraud, conspiracy, negligence, and related claims arising out of the Ecuadorian litigation. *See Chevron Corp. v. Donziger*, 768 F. Supp. 2d 581, 594 (S.D.N.Y. 2011), *vacated sub nom. Chevron Corp. v. Naranjo*, No. 11-1150-CV L, 2011 WL 4375022, at *1 (2d Cir. Sept. 19, 2011), *rev'd and remanded sub nom. Chevron Corp. v. Naranjo*, 667 F.3d 232 (2d Cir. 2012), *cert. denied*, 133 S. Ct. 423 (2012). Chevron sought damages and other relief against those who had orchestrated the Ecuadorian lawsuit, arguing that the judgment had been based heavily on a court-appointed expert's report, which had been ghostwritten by an environmental engineering firm working for the plaintiffs' attorneys. The suit is scheduled for trial in October 2013. At the same time, Chevron resisted any effort to domesticate and enforce the Ecuadorian judgment, pointing to the claims that it had been procured through fraud.

Chevron asserted several claims against the Ecuadorian plaintiffs' Colorado-based environmental engineering firm and its principals ("the insureds") premised on fraud, racketeering, and related allegations. *See Navigators Specialty Ins. Co. v. Beltman*, No. 11-cv-00715-RPM, 2012 WL 5378750, at *1 (D. Colo. Nov. 1, 2012). Chevron alleged that the Ecuadorian suit was "sham litigation" and that the defendants in the New York action, "including [the insureds] and their coconspirators ha[d] sought to extort, defraud and otherwise tortiously injure Chevron by means of a criminal scheme to: (i) intimidate or corrupt the Lago

Agrio court and obtain a fraudulent judgment against Chevron based on manufactured evidence of liability; (ii) collude with the Republic of Ecuador to procure sham criminal charges against Chevron's attorneys; and (iii) conduct a massive public pressure campaign designed to spread false and misleading information about Chevron and the Lago Agrio litigation." *Id.*

The essence of Chevron's allegations against the insureds was an extensive fraudulent scheme of "ghostwriting" key environmental reports to "jack [the Ecuadorian case] up to thirty billion." *Id.* at *3, *4. It was, as put most eloquently by the chief U.S. plaintiffs' lawyer, a campaign "*of smoke and mirrors and bullshit*." *Chevron*, 768 F. Supp. 2d at 608 (emphasis in original). Most egregiously, the co-conspirators allegedly "arranged the appointment of Richard Stalin Cabrera Vega ('Cabrera') as the Ecuadorian court's sole expert to conduct a 'global damages assessment.'" *Navigators*, 2012 WL 5378750, at *2. This assessment was secretly authored by the insureds and adopted "pretty much verbatim." *Id.* But the alleged artifice did not end there. The insureds then "drafted 'comments' purporting to criticize 'the Expert's work and conclusions,' even though they had written his initial report themselves, and then ghostwrote 'Cabrera's' responses to their own 'comments,' increasing his fake damage assessment to more than $27 billion." *Id.*

Chevron's claims of fraud were bolstered by the fact that the U.S. lawyer for the Ecuadorian plaintiffs had allowed a documentary film crew to become embedded with the plaintiffs' legal team, resulting in the 2009 documentary film *Crude*. Outtakes from the film captured meetings between the plaintiffs' lawyers and experts, including a meeting in which one of the insureds—from a Colorado-based environmental engineering firm—told the plaintiffs' lead counsel that there was no evidence that contamination had spread from the oil pits and that "nothing has spread anywhere at all." The plaintiffs' lawyer responded, "This is Ecuador, O.K. . . . . At the end of the day, there are a thousand people around the courthouse, you will get whatever you want. Sorry, but it's true." *See* Clifford Krauss, *Lawyer Who Beat Chevron in Ecuador Faces Trial of His Own*, N.Y. Times, July 30, 2013, at B1. The outtakes were eventually disclosed to Chevron in the litigation, which used them as a central part of its case.

To avoid the potential financial fallout of the New York litigation, the insureds sought coverage under: (1) an E&O policy; (2) a D&O policy; and (3) a CGL policy with an umbrella policy containing substantially similar language. *Navigators*, 2012 WL 5378750, at *2. All three insurers disclaimed coverage. The E&O insurer relied on an intentional-acts exclusion, as did the CGL insurer, in part. The CGL and D&O insurers also relied on professional-services exclusions contained in their respective policies.

The E&O insurer brought a declaratory judgment action in Colorado federal court against the insureds, seeking a determination that no defense was owed under its policy. The insureds counterclaimed for bad faith and asserted similar claims against the CGL and D&O insurers.

The insurers all moved for summary judgment, arguing they did not owe a defense to the insureds under Colorado law, and that without a duty to defend, there is no duty to indemnify. Colorado Federal District Judge Richard Matsch, who was the well-known jurist who had presided over the Oklahoma City Bombing trials of Timothy McVeigh and Terry Nichols, issued a thorough opinion granting the insurers' respective motions and dismissing the insureds' claims.

The court largely assumed that the insureds could meet the insuring agreement of each policy. Colorado, like many United States jurisdictions, follows the "complaint rule" or "four-corners rule," which dictates "comparing the underlying complaint with the coverage language of the policy to find whether the factual allegations made against the insured, if sustained, state a claim which is potentially or arguably within the policy coverage." *Id.* (citing *Hecla Mining Co. v. N.H. Ins. Co.*, 811 P.2d 1083 (Colo. 1991)). Under this approach, words undefined in the policies are given their "plain meaning" and enforced as written in the absence of ambiguity. *See id.* at *5-6.

When the court applied this methodology, the intentional-acts exclusions precluded coverage for the insured under the E&O and CGL policies. While such exclusions have historically been invoked in the context of relatively quotidian intentional torts like assault, battery, or arson, the "plain meaning" of intentional-acts exclusions applies no less to fraudulent or intentionally dishonest conduct.

For example, the E&O policy's "Intentional Acts" exclusion barred coverage for any "dishonest, fraudulent, malicious or knowingly wrongful act, error or omission." *Id.* at *5. The court noted that the terms "dishonest, fraudulent, malicious, or knowingly wrongful" were not defined in the policy. *Id.* Even so, "'dishonest' is a synonym for 'untruthful'," and "'fraudulent or dishonest' in an insurance context" means "an act 'for a wrongful purpose and moral obliquity.'" *Id.* (citations omitted). "[M]alicious" includes "acts done intentionally or with willful disregard of likelihood of damage." *Id.* (citations omitted). "Knowingly" means "with knowledge; consciously; intelligently; willfully, intentionally." *Id.* (citation omitted). And "'wrongful' means 'unlawful' or 'unjust.'" *Id.* (citation omitted).

Applying these definitions, the court stated that the "Chevron Action [wa]s entirely premised on the alleged scheme by [the insureds] and others to intentionally 'extort, defraud, and otherwise tortiously injury' the Chevron Corporation." *Id.* at *10. The "Chevron Action [wa]s replete with allegations that [the insureds'] composition of the Cabrera Report and related materials 'was intended to deceive' by making 'deliberate misrepresentations' and perpetuating 'deliberate falsehoods,' which they did 'knowingly and intentionally . . . and with [the] intent to deceive.'" *Id.* This precluded any claim to defense or indemnity.

Critically, the court rejected an argument that coverage was implicated by a commingling of intentional and negligent conduct. *Id.* at *5. The insureds asserted that "while it may be that they should have known that something was not legitimate in the relationship among [the 'co-conspirators'], the Ecuadorian plaintiffs and Cabrera, the work done in connection with the Cabrera report may have only been negligent." *Id.* But the court was not persuaded. While negligence was pled, "the factual allegations for that claim [we]re the same as the [conspiracy] allegations." *Id.* As such, the E&O carrier had no duty to defend.

The same was true under the CGL policy. A "Knowing Violation Of Rights Of Another" exclusion made "clear that there c[ould] be no coverage for knowing and intentional violations of the law, which [wa]s exactly what [the insured] [wa]s alleged to have done in the Chevron [A]ction." *Id.* A "Material Published With Knowledge of Falsity" exclusion, which barred

coverage for injuries "arising out of oral, written or electronic publication of material, if done by or at the direction of the insured with knowledge of its falsity,'" likewise barred coverage. *Id.* The "Chevron Action [wa]s replete with allegations of intentional misrepresentations." *Id.* Indeed, the "thrust of the claims against the [insureds] [wa]s the fabrication and publication of the Cabrera Report and supporting material." *Id.* As such, the CGL insurer had no duty to defend.

Thus, intentional-acts exclusions are rooted in the fortuity principle of insurance and reflects the public policy prohibiting coverage for intentional and malicious acts. *See Freightquote.com, Inc. v. Hartford Cas. Ins. Co.*, 397 F.3d 888, 893-94 (10th Cir. 2005); *Bailey v. Lincoln Gen. Ins. Co.*, 255 P.3d 1039, 1047 (Colo. 2011). Intentional-acts exclusions "are necessary to help insurers set rates and supply coverage" such that "[i]f a single insured is allowed, through an intentional act, to consciously control risks covered by the policy, the central concept of insurance is violated." *Bailey*, 255 P.3d at 1047 (citations omitted). Such exclusions prevent "giving insureds license to engage in intentional misconduct," which may be more likely if "insured[s] believe [they] will not have to bear the financial costs of the intentional conduct.'" *Id.* at 1047-48 (citing *Couch on Insurance* § 101–21 (2006)).

Intentional-acts exclusions operate to properly place the burden of fraudulent or intentional conduct on insureds. Even when the specter of negligence is raised, sufficient allegations of intentional conduct can cause the apparition to disappear. Insurers and those who represent them would be wise to raise intentional-acts exclusions whenever possible to avoid potentially unnecessary expenditures of millions (or billions) of dollars in defense and indemnity costs arising out of corporate fraud or other intentional misconduct.

Another significant issue in determining whether an intentional-acts exclusion bars a defense obligation is whether the substantive law of the governing jurisdiction requires or allows an insurer to consider facts outside the underlying complaint. In *Navigators*, the policy was governed by Colorado substantive law. Colorado is a strict "four corners" state in determining whether a duty to defend is owed under a general liability policy. Colorado's version of the four-corners rule does not differentiate between policies that provide a duty to defend (*e.g.*, general liability policies) and policies that require an insurer to reimburse defense costs without assuming a "duty to defend." Thus, insurers that have policies providing for reimbursement of defense costs—without creating a duty to defend—are equally to avail themselves of, or be subject to, the four-corners rule in determining whether the defense obligation is triggered.

Furthermore, in *Navigators*, The E&O and CGL insurers successfully argued that professional-services exclusions in their respective policies barred coverage. The CGL insurer also obtained summary judgment based on a "Testing Or Consulting Errors and Omissions" exclusionary endorsement.

Applying the professional-services exclusions, the court noted that "the Chevron claims against the [insureds] are premised on their provision of 'various environmental consulting services' to the U.S. plaintiffs' attorneys in the Ecuadorian litigation," including ghostwriting the court-appointed expert's report. *Navigators*, 2012 WL 5378750, at * 7. The court noted that the insureds were allegedly able to perpetrate the fraud precisely because of their professional status,

utilizing the professional jargon of their specialized field to generate a convincing, albeit fraudulent, expert report. They further traded off of their status as professionals by allegedly offering commentary on the ghostwritten report, claiming to endorse the conclusions contained in the report based on their independent exercise of professional judgment. Thus, their professional services were an "integral part" of the alleged fraud scheme, and not some incidental or irrelevant factor in the commission of the alleged fraud. *Id.* Later, the court stated, "[b]ecause this endorsement excludes coverage for claims that 'aris[e] out of . . . any professional services by [the insureds],' and the allegations against the [insureds] in the Chevron Action arise out of the [insureds'] provision of professional services to the plaintiffs' lawyers in the Ecuadorian lawsuit, this endorsement bars coverage for the Chevron Action." *Id.* at * 11.

Similarly, the court applied the Testing and Consulting Errors and Omissions exclusion, stating: "Because the claims against the [insureds] 'aris[e] out of' the 'evaluation' or 'consultation' provided in the form of the Cabrera Report and related documentation, this exclusion bars all coverage here." *Id.*

The insureds timely appealed to the United States Court of Appeals for the Tenth Circuit, but then dismissed the appeal before any briefs were filed, cementing the trial court's decision as the final ruling on the matter.

High-stakes D&O and E&O litigation is on the rise in Colorado as elsewhere. The case law is slowly adapting to catch up. Most of Colorado's published duty-to-defend cases address typical general-liability coverage issues, not policy forms that call for reimbursement of defense costs. Most published intentional-act cases in Colorado involve sexual assaults or other acts of violence, not white-collar fraud. The small handful of cases addressing professional-services exclusions in Colorado deal with traditional medical fields, not the gray areas of business consulting firms that constitute so much of the service sector today. The Colorado coverage fallout from the Chevron litigation shows that comprehensive briefing and careful judging can compensate for the lack of a mature body of on-point case law, and eventually contribute to a more robust body of law capable of addressing increasingly complex D&O and E&O claims.