

ALERT

DISPUTES / INSURANCE LITIGATION

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Fourth Circuit Confirms That Equitable Claims Against the Gun Industry Are Not Covered by General Liability Insurance

The Fourth Circuit Court of Appeals has confirmed that claims against the firearm industry seeking equitable remedies in an effort to change the way the industry does business are not covered under general liability insurance contracts because the claims do not seek “damages.” According to the Court in *Ellett Brothers, Inc. v. USF&G*, ___ F.3d ___, No. 01-1130, 2001 WL 1660888 (4th Cir. December 28, 2001),¹ a declaratory judgment action arising out of four underlying suits against Ellett Brothers, Inc. and other members of the gun industry, the underlying suits for which Ellett sought a defense did not seek “damages” covered under its general liability insurance contracts. Rather, the four suits seek a variety of equitable and preventative measures in an attempt to change the manner in which Ellett and the gun industry conduct business. Because the suits do not seek compensation for past injuries, however, Ellett would not be entitled to a defense in those suits.

1. Shaw Pittman attorneys represented USF&G in this matter.

A. The Term “Damages” Means “Legal Damages.”

In *Ellett*, the four underlying lawsuits allege that Ellett sold, marketed and distributed firearms in a manner that created an allegedly illegal secondary market through which minors, criminals and other prohibited users could obtain handguns. St. Paul contended in its summary judgment motion that the underlying claims were not covered because they did not seek damages and alleged harm that was caused by intentional conduct. The district court ruled in St. Paul’s favor, finding that the underlying lawsuits seek relief that is merely “equitable in nature.” *Ellett Brothers, Inc. v. USF&G, et al.*, No. 3:00-1269-19, slip op. at *2 (D.S.C., Dec. 6, 2000).

Challenging that decision, the issue raised by Ellett on appeal was whether the term “damages,” as that term is used in a commercial general liability contract, includes amounts that a policyholder might become obligated to pay in connection with complying with various forms of equitable relief. The Fourth Circuit, applying South

Carolina law, concluded that the term “damages” does not include amounts paid in equity. *Ellett*, slip op. at *1. Rather, the term only extends to amounts that constitute legal “damages.” *Id.* Based on its earlier decision in *Cincinnati Ins. Co. v. Milliken and Co.*, 857 F.2d 979 (4th Cir. 1988), the Court reasoned that, under South Carolina law, neither injunctive nor equitable relief constitute “damages” covered by general liability insurance. *Ellett*, slip op. at 4. As in *Milliken*, the Court reasoned that the term “damages” is not ambiguous. *Id.* at *1. Thus, affording the term its plain and ordinary meaning, the Court concluded, as it did in *Milliken*, that the term does not include amounts that the insured becomes obligated to pay in equity. *Id.* Rather, the term only extends to amounts “which the insured becomes legally obligated to pay.” *Id.* (emphasis added). The *Ellett* Court confirmed *Milliken* as the correct interpretation of South Carolina law, explaining that in the three years since *Milliken* was decided, no decision from a South Carolina court has called into question the validity of that decision. *Ellett*, slip op. at *1.

B. Suits Against The Gun Industry Do Not Seek Damages

The Underlying Allegations

Ellett sought coverage for four underlying lawsuits. California municipalities, including the City of San Francisco, the City of Los Angeles, and the County of Los Angeles brought three of the suits. The NAACP and the National Spinal Cord Injury Association brought the

fourth underlying suit. Each of the four lawsuits alleged that Ellett created and contributed to the maintenance of a public nuisance through the manner in which it sold, marketed and distributed handguns. According to the Complaints in each of the four underlying suits, Ellett intentionally contributed to the creation of an allegedly illegitimate secondary handgun market through which children, criminals and other illicit users could easily obtain possession of a handgun without being subject to normal market safeguards. The three municipal suits each seek to abate the illegitimate secondary market and the resulting public nuisance. The NAACP lawsuit seeks to enjoin certain allegedly negligent and intentional conduct that has led to the proliferation of illegal handguns and also seeks the establishment and funding of an educational program for the education, supervision and regulation of retail gun dealers.

The Underlying Lawsuits Do Not Seek “Damages”

The Fourth Circuit concluded that none of the underlying lawsuits seeks damages from Ellett, although they do seek money from Ellett in the form of restitutionary payments, disgorgement of profits, civil penalties, attorney’s fees, costs of suit and interest. *Ellett*, slip op. at *2. As the Court explained, restitution and disgorgement are not compensatory damages, but are amounts that represent Ellett’s ill-gotten gains. *Id.* at *2. Likewise, civil penalties are not damages payable to a victim, but are amounts paid to the government and, thus, they are distinguishable from covered damages. *Id.* Further, inci-

dental costs of litigation such as pre- and post-judgment interest, costs and attorneys fees do not constitute “damages” within the meaning of a contract for general liability insurance. *Id.* Rather, the *Ellett* Court found that such amounts are specifically addressed under the policies’ Supplementary Payments provisions, which do not become implicated unless and until coverage is otherwise available under the policies.

Lastly, the *Ellett* Court concluded that prayers for “such further relief” do not amount to a claim for damages and, thus, cannot properly be relied upon to trigger an insurer’s duty to defend. *Id.* Rather, an insurer’s duty to defend is determined from a reading of the factual allegations in the underlying complaint. *Id.* A prayer for “such further relief” is not a factual allegation. *Id.* Significantly, this aspect of the Court’s opinion directly undermines the controversial decision in *Scottsdale Ins. Co. v. RSR Management Co.*, 2000 U.S. Dist. LEXIS 14160 (E.D.N.Y. 2000), in which a federal trial court in New York permitted such a prayer to trigger an insurer’s duty to defend. That decision was not appealed, however.

C. The Underlying Suits Do Not Seek “Damages” In The Ordinary Sense of the Word

In a concurring opinion, Judge Michael wrote that notwithstanding the majority’s distinction between legal and equitable relief, the underlying suits are not covered under *Ellett*’s general liability insurance because none of

the suits seeks compensation, of any kind, for past injuries. *Ellett*, slip op. at *5.² Rather, as Judge Michael explained, the underlying suits seek only to prevent future firearm-related injuries by changing the manner in which the gun industry conducts business. *Id.* In reaching his conclusion, Judge Michael explained that the plain, ordinary and popular meaning of the term “damages” means “money for detriment or injury sustained.” *Id.* (quoting *Webster’s Third New Int’l Dictionary of the English Language* at 571 (1989), and citing other authority). Judge Michael then explained how none of the underlying lawsuits seek money for detriment or injury sustained, but rather seek only to prevent future injuries — a critical distinguishing feature. *Id.*

Implications

- *Ellett* confirms that general liability insurance does not apply to amounts paid to comply with equitable relief.
- *Ellett* also confirms that regardless of the label attached to the type of relief sought by an underlying claimant, only those amounts that seek to compensate for past injury or harm will be covered under a

1. Judge Michael questioned whether *Milliken* is correct in its interpretation of South Carolina law on the legal/equitable distinction because a subsequent decision by the South Carolina Court of Appeals in *Braswell v. Faircloth*, 387 S.E.2d 707 (S.C. Ct. App. 1989) suggests that some amounts paid in equity (e.g. environmental response costs) could be covered by general liability insurance.

general liability insurance contract. Amounts paid to prevent future injury will not be covered. *Ellett* demonstrates, therefore, that the outcome of future firearm-related coverage actions likely will turn on the specific allegations of the underlying liability claim or lawsuit. It remains imperative, therefore, that claim and legal personnel carefully review the facts and allegations of each claim, paying particular attention to the relief sought in each lawsuit.

- *Ellett* also confirms that only factual allegations can properly be considered in determining an insurer's duty to defend. Prayers for relief may not be considered. The different conclusions reached between *Ellett and Scottsdale* on this point demonstrate the importance of forum selection and choice of law. In *Ellett*, for example, the Court rejected the policyholder's argument that the boilerplate language in the underlying complaint seeking "such further relief" created the possibility of an award of "damages" under South Carolina law. That same argument, however, successfully triggered an insurer's duty to defend under New York law. See *Scottsdale*, 2000 U.S. Dist. LEXIS 14160 at *5.

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