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Insurance Bad Faith

Pitfalls For The Unwary: The Use Of Releases To Preserve Or Extinguish Any Potential Bad-Faith Claims Between The Primary And Excess Insurance Carriers

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Commentary

Pitfalls For The Unwary: The Use Of Releases To Preserve Or Extinguish Any Potential Bad-Faith Claims Between The Primary And Excess Insurance Carriers

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I. Introduction

The liability claim has settled and you now have a release. That may put an end to things, but things are not always that simple. It is easy to forget that a release does more than memorialize an agreement between two parties. It remains a tool, primarily used as a shield from further litigation; but — depending on the language used — a carefully (or carelessly) worded release can manifest an intent to initiate or continue litigation against certain parties. Claims professionals and their attorneys are typically familiar with the issues that can develop regarding claims involving a single claimant, or even multiple claimants, and a single insurer, and the need to address any lingering bad-faith concerns. However, it is easy to overlook the issues that compound when more than one insurer participates in the settlement.

Some jurisdictions, particularly Florida, have given recent scrutiny to the actions and duties between primary and excess insurance carriers regarding the handling and resolving of liability actions against a mutual insured. The questions posed in these suits revolve around the duties and obligations, if any, that exist between the primary insurer and the excess insurer to handle a claim in good faith. Based on these cases, it is clear that nuances in the terms of a release and settlement agreement can make a significant difference in determining whether a potential claim for bad faith between an excess insurance carrier and primary insurance carrier has been preserved or extinguished.

II. Consider Your Jurisdiction: Does Your Jurisdiction Recognize A Cause Of Action For Bad Faith Between Two Insurers?

A. No Recognized Cause Of Action

Some states simply do not permit an excess insurance carrier to sue a primary carrier for bad faith in failing to settle a liability claim against a mutual insured.[1] As an example, courts applying Missouri law do not recognize a direct duty of good faith between a primary and secondary insurer.[2] In *American Guarantee & Liability Insurance Co. v. United States Fidelity & Guaranty Co.*,[3] the court also rejected a claim for bad faith based upon theories of subrogation or assignment.

In *American Guarantee*, an excess insurer sought to recover $17 million against the primary insurance carrier for failing to settle a lawsuit in good faith. The underlying lawsuit related to a wrongful-death claim stemming from a tractor-trailer accident. The excess carrier received a late notice of the lawsuit.[4] After evaluating the case, the excess carrier sent a series of letters to the primary carrier urging it to settle the claim within its $5 million policy limits.[5] The matter went to trial and the jury awarded the underlying plaintiff $46 million.[6] The excess carrier later negotiated this amount down and initiated suit against the primary carrier.

The primary carrier then moved for summary judgment. The court rejected the excess insurer's claim for subrogation, stating that the insured has the exclusive right to proceed against the tortfeasor.[7] Because the excess carrier did not sue in the name of the insured, no claim for contractual or equitable subrogation could proceed.[8] The court further noted that Missouri law does not permit the assignment of a claim for failure to settle.[9]

The Supreme Court of Alabama addressed similar issues in the case of *Federal Insurance Co. v. Travelers Casualty and Surety Co.*[10] There, an insured and its excess insurance carrier sued the primary insurance carrier for failure to settle. The case proceeded in the federal district court and was appealed to the United States Court of Appeals for the Eleventh Circuit. The Eleventh Circuit certified two questions to the Alabama Supreme Court.[11] The Alabama court modified the questions as follows:

> 1) Whether, absent any specific contractual duty, a primary insurance carrier owes a duty of good faith in each, or all, of the following duties to an excess carrier in its conduct of the defense of an insured who is insured by both: duty of good faith to settle; duty of good faith in deciding whether to settle; and duty of good faith in deciding to keep the excess carrier informed of settlement negotiations and adverse developments.
>
> 2) Whether an excess carrier, whose insured was "never subject to a final judgment ordering the payment of money that [the insured] personally- and not his insurer — would have to pay," can be equitably subrogated to the rights of the insured arising out of the foregoing duties against the primary carrier in the conduct of its defense of the mutual insured.[12]

The Alabama Supreme Court answered both of these questions in the negative. The Court noted that the typical policy considerations underlying duties of good faith between an insured and insurance company do not exist in the relationship between an excess and primary insurer.[13] The *Federal Insurance* court also rejected the claim for equitable subrogation. It reasoned that such a claim would not exist where the insured was not subject to personal loss from a final judgment.[14]

B. Recognized Causes Of Action, Either Direct, Under Assignment, Or Through Subrogation Principles

Other jurisdictions recognize a cause of action between primary and excess insurance carriers under various theories including assignment or equitable subrogation.[15] The California case of *Peter v. Travelers Insurance Co.*,[16] explained the rationale for these decisions stating:

> An insurance company's duty to act in good faith in settling claims within its policy limits is well established and is reflected in its premiums. That an excess insurer may recover from the primary in breach of duty does not increase the duty or the liability of the primary. Under the doctrine of equitable subrogation, the duty owed an excess insurer is identical to that owed the insured. The excess will not be able to force the primary into accepting any settlement which his duty to the insured would not require accepting. . . . In considering whether it will settle a claim, the primary insurer may consider its own interests, but it must equally consider the interests of the insured, which become the interests of the excess insurer by subrogation.

III. Recent Examples In Florida

In the case of *Perera v. United States Fidelity & Guaranty Co.*,[17] the Florida Supreme Court answered the question of whether an insurer could be liable for bad faith where the insurer's actions never exposed the insured to any liability in excess of the policy limits of the insured's policy.[18] The Florida court addressed the same question faced by the Alabama Supreme Court in its *Federal Insurance* opinion- can the insurance company be subrogated for a bad-faith claim where the insured was never at risk for harm. However, the *Perera* Court reached the opposite conclusion and discussed how such a suit could proceed.

In *Perera*, a worker was injured and sued his employer and certain fellow employees. The employer carried three policies of insurance, including two primary policies and one excess policy. The first primary policy (which insured only the employees) was a general commercial liability policy with a limit of $1 million. The second primary policy (which insured only the employer) was an excess workers' compensation

employer's liability policy with a limit of $1 million. The final policy was an umbrella excess liability policy with a limit of $25 million.[19]

During the litigation, one of the primary carriers (i.e., the worker's compensation employer's liability carrier) denied coverage and did not meaningfully participate in settlement negotiations.[20] The umbrella excess carrier took the active role in the negotiations and reached a $10 million settlement and consent judgment.[21] The first $5 million of the settlement would be paid by the insured employer, the commercial liability carrier, and the excess umbrella carrier.[22] The insured employer assigned the remaining $5 million to the injured worker to pursue in a breach of contract and bad-faith action against the non-settling primary carrier.[23]

The case proceeded in federal court and the worker received a summary judgment in its favor for the $1 million policy limits in its breach of contract action.[24] With regard to the bad-faith claim, the district court initially entered summary judgment in the favor of the non-settling primary carrier, holding that there can be no bad-faith action because no excess judgment had been rendered. The issue was appealed and, on remand, a jury found the carrier had acted in bad faith.

The carrier again appealed and the Eleventh Circuit Court of Appeals certified questions related to the lack of excess judgment and lack of extracontractual exposure to the Florida Supreme Court.[25] The Florida Supreme Court rephrased the question as follows:

> May a cause of action for third-party bad faith against an indemnity insurer be maintained when the insurer's actions were not a cause of the damages to the insured or when the insurer's actions never resulted in exposure to liability in excess of the policy limits of the insured's policies.[26]

The court then discussed four "recognized circumstances" where a litigant may generally assert a common law third-party bad-faith action against an insurer.[27] Only the fourth scenario applies to this article — when the primary insurer's bad-faith refusal to settle causes the excess insurer to pay an amount greater than it would have if the primary insurer had acted in good faith.[28] The *Perera* Court noted a singular necessary thread among each of the scenarios it discussed. Under each, a plaintiff must establish a causal connection between the damages claimed and the action constituting bad faith.

After discussing each of the "widely recognized" bad-faith circumstances, the *Perera* court determined that none of the circumstances applied in its case. The non-settling primary carrier's actions did not cause the insured to be exposed to the remaining $4 million or face any exposure above its policy limits. Therefore, the insured's assignee was not entitled to recover the unpaid portion of the consent judgment.[29]

However, the significance of the case lies in a suggestion by the court in a footnote. The Court specifically stated that had the excess umbrella insurance carrier assigned *its* claim against the non-settling primary carrier for equitable subrogation, the worker's claim would have been able to proceed.[30] If the excess carrier had proceeded with its own claim or assigned its claim to the injured worker, the measure of damages would have been the difference between amount the excess insurer paid and the amount it would have paid had the non-settling primary carrier settled in good faith.[31]

Within days of the *Perera* Court's decision, Florida's Fourth District Court of Appeal issued a decision further discussing the consequence of bad-faith conduct between an excess insurer and primary insurer.[32] In *Vigilant Insurance Co. v. Continental Casualty Co.*,[33] an excess insurer appealed the dismissal of its complaint. The trial court had ruled that the injured third party had released the insured and the excess carrier did not receive an assignment of any bad-faith claim.[34] The appellate court reversed the decision.

In the underlying case, an injured party brought suit against an insured manufacturer. The insured held a primary insurance policy in the amount of $1 million and an excess policy in the amount of $25 million. In early settlement negotiations, the injured party made a demand within the primary insurance policy. The primary carrier rejected the demand and did not notify the excess carrier about the demand. After three more years of litigation, the demand exceeded the primary insurance policy and the excess carrier was notified. The claim eventually settled for $1.7 million. The injured party executed a settlement agreement releasing the insured, the primary carrier, and the excess carrier.

The excess carrier then sued the primary carrier for the $1.2 million it paid in excess coverage. The primary carrier moved to dismiss on two grounds. First, because the parties had been released and no bad-faith claim had been assigned to the excess carrier, the claim could not be maintained. Second, because the underlying suit settled, the insured never had an excess judgment entered against it.

In rejecting the primary carrier's arguments, the *Vigilant* court explained that an excess judgment is not a prerequisite to a bad-faith claim between an excess and primary insurer.[35] The court stated that the primary insurer has the same duty to exercise good faith to an excess carrier as it does to an insured.[36] Because the excess carrier proceeded under a theory of equitable subrogation, it did not need any assignment from the insured.[37]

The *Vigilant* court further reasoned that any party paying money to resolve a claim, whether the insured or an excess carrier, would seek a release of the insured and satisfaction of any judgment.[38] Obtaining a release from the third party under those circumstances does not eliminate the damage the insured or its excess carrier has suffered. The release only prevented the third party from suing the insurers for bad-faith refusal to settle; the release did not prevent the excess carrier from suing the primary carrier to recover its own damages under the theory of equitable subrogation.

The court indicated that the insured did not release any potential bad-faith claim it held.[39] Only if the insured had released the primary insurer "might" the release have affected the excess carrier's ability to make a claim against the primary carrier.[40]

IV. Conclusion

In situations involving multiple layers of insurance, where the insured or its excess carrier pays or settles the claim against the insured in an amount exceeding the primary limits, the parties entering into and approving releases need to ensure that they consider any implications for a cause of action involving bad faith between the insurance carriers. To extinguish possible claims, the carriers should consider whether they want to request a separate release from their insureds of any claims arising out of the handling of the claim. Alternatively, as additional consideration to encourage a settlement with a third-party claimant, the excess insurer may wish to offer an assignment of its claims against the primary carrier.

Endnotes

1. *See, e.g.*, American Guar. & Liab. Ins. Co. v. United States Fid. & Guar. Co., 693 F. Supp. 2d 1038 (E.D. Mo. 2010); Federal Ins. Co. v. Traveler's Cas. & Sur. Co., 843 So. 2d 140 (Ala. 2002)(noting that absent specific contractual provisions, Alabama does not recognize a duty of good faith to settle or to keep the excess carrier informed of settlement negotiations); Acceptance Indemn. Ins. Co. v. Liberty Mutual Ins. Co., No. 2006-CA-001867, 2009 WL 275834, at *2 (Ky. Ct. App. Feb. 6, 2009) (noting that Kentucky has neither recognized nor specifically rejected such a cause of action).

2. American Guar. & Liab. Ins. Co. v. United States Fid. & Guar. Co., 693 F. Supp. 2d at 1048, *citing* Reliance Ins. Co. v. Chitwood, 433 F.3d 660, 664 (8th Cir. 2006).

3. 693 F. Supp. 2d 1038 (E.D. Mo. 2010).

4. *Id*. at 1045. The excess carrier did not pursue the issue of the late notice. *Id*. at n.17.

5. *Id*. at 1045-46.

6. *Id*. at 1046.

7. *Id*. at 1049, citing Warren v. Kirwan, 598 S.W.2d 598, 599 (Mo. Ct. App. 1980).

8. *Id*. at 1049.

9. *Id*. at 1050, *citing* Quick v. Nat'l Auto Credit, 65 F.3d 741, 746-47 (8th Cir. 1995).

10. 843 So. 2d. 140 (Ala. 2002).

11. Federal Ins. Co. v. Travelers Cas. Sur. Co., 280 F.3d 1356, 1357 (11th Cir. 2002).

12. Federal Ins. Co. v. Travelers Cas. Sur. Co., 843 So. 2d at 141-42 (quoting Evans v. Mutual Assurance Inc., 727 So. 2d 66, 68 (Ala. 1999)).

13. *Id*. at 143-144. These policy considerations include such factors as the difference in bargaining power, contractual or litigation experience, and the right to intervene and participate in the settlement of the claim. *Id*.

14. *Id*. at 144-45.

15. *See*, *e.g*., U.S. Fire Ins. Co. v. Morrison Assurance Co., 600 So. 2d 1147, 1151 (Fla. 1st DCA 1992), *citing*, Ranger Ins. Co. v. Traveler's Indem. Co. 389 So. 2d 272 (Fla. 1st DCA 1980), *see also* AMHS Ins. Co v. Mutual Ins. Co., 258 F.3d 1090, 1100-01 (9th Cir. 2001). Note that Arizona does not recognize a similar subrogation right between equal-level insurers. *Id*. at 1100, *citing*, Hartford Accident & Indemn. Co. v. Aetna Cas. & Sur. Co., 164 Ariz. 286, 792 P.2d 749 (1990); Peter v. Travelers Ins. Co., 375 F. Supp. 1347 (C.D. Cal. 1974); see also Schwartz v. Twin City Fire Ins. Co., 492 F. Supp. 2d 308 (S.D. N.Y. 2007) (noting a direct duty to an excess carrier where a primary insurer acts with gross disregard to the excess carrier's interest).

16. 375 F. Supp. 1347, 1350 (C.D. Cal. 1974).

17. 35 So. 3d 893 (Fla. 2010).

18. Perera v. United States Fid. & Guar. Co., 35 So. 3d at 895.

19. *Id*.

20. Id. at 896. During mediation the primary carrier insisted on its defense coverage and refused to tender its policy limits.

21. *Id*.

22. *Id*.

23. *Id*.

24. *Id*. at 897.

25. Perera v. United States Fid. & Guar. Co. 544 F.3d 1271, 1279 (11th Cir. 2008).

26. Perera v. United States Fid & Guar. Co., 35 So. 3d at 895.

27. *Id*. at 899-90. The first scenario is where the insured has an excess judgement entered against him. The second is where an insurer and third-party litigant agree to try bad-faith issues prior to the liability issues. *See* Cunningham v. Standard Guar. Ins. Co., 630 So. 2d 179, 182 (Fla. 1994). The third is when an insured reaches a settlement with a third party and consents to an adverse judgment. *See* Coblentz v. United States Sur. Co. of N.Y., 416 F.2d 1059, 1063 (5th Cir. 1969). The fourth scenario is when an excess carrier brings an action against a primary carrier under the theory of equitable subrogation. U.S. Fire Ins. Co. v. Morrison Assurance Co., 600 So. 2d 1147, 1151 (Fla. 1st DCA 1992), *citing*, Ranger Ins. Co. v. Traveler's Indem. Co. 389 So. 2d 272 (Fla. 1st DCA 1980).

28. Perera v. United States Fid. & Guar. Co., 35 So. 3d at 900.

29. *Id*. at 904.

30. *Id*. at n.13.

31. *Id*.

32. Vigilant Ins. Co. v. Continental Cas. Co., 33 So. 3d. 734 (Fla. 4th DCA 2010).

33. 33 So. 3d. 734 (Fla. 4th DCA 2010).

34. *Id*. at 735.

35. *Id*. 737, *citing*, RLI Ins. Co. v. Scottsdale Ins. Co., 691 So. 2d 1095, 1096 (Fla. 4th DCA 1997).

36. *Id*., *citing* Ranger Ins. Co. v. Traveler's Indem. Co. 389 So. 2d 272 (Fla. 1st DCA 1980); General Acc. Fire & Life Assur. Corp. v. Am. Cas. Co. of Reading, Pa. 390 So. 2d 761 (Fla. 3d DCA 1980), rev. denied, 399 So. 2d 1142 (Fla. 1981); Phoenix Ins. Co. v. Florida Farm Bureau Mut. Ins. Co., 558 So. 2d 1048 (Fla. 2d DCA 1990).

37. *Id*. at 737, *citing*, Ranger Ins. Co., 389 So. 2d at 273.

38. *Id*. at 738-39.

39. *Id*. at 739.

40. *Id*. ■

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