

Montana Supreme Court Rules State Farm Did Not Act in Bad Faith Because it had a Reasonable Basis to Refuse Settlement Offer

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Summary: Automobile insurer filed suit seeking declaratory judgment that “Limits of Liability” for “Each Person” limited coverage on derivative claims brought by passenger’s daughter for passenger’s death as a result of a car accident caused by insured’s negligence to \$50,000 limit that had already been paid to passenger’s estate. The insured and personal representative of passenger’s estate, who was also acting as a conservator for the daughter, filed a counterclaim for breach of policy and bad faith. The District Court ruled that the insurer had correctly interpreted “Each Person” limit of liability. However, the Montana Supreme Court reversed and remanded (Freyer I). On remand, the insured and personal representative/conservator amended the counterclaim adding a claim for violation of the Unfair Trade Practices Act (UTPA) and sought enforcement against insurer of a stipulated judgment of \$2.7 million in the suit brought by personal representative/conservator against insured for wrongful death. The District Court entered summary judgment in insurer’s favor on all claims. However, the Supreme Court held that the insurer’s reliance on precedent at time of claim was not an affirmative defense to a claim for policy breach, but the stipulated judgment between the insured and the personal representative/conservator was not an appropriate measure of consequential damages to passenger’s daughter for insurer’s breach of duty to indemnify. Moreover, insurer did not act in bad faith or breach its duty of good faith and fair dealing by refusing the settlement offer on daughter’s claims. Further, insurer did not misrepresent the scope of coverage on daughter’s claim under the provision for “Each Person” Limit of Liability under the UTPA. (Freyer II)

State Farm v. Freyer

Heath Freyer (Heath) and Vail Freyer (Vail), were married and the parents of Alicia Freyer (Alicia). All three were riding in their vehicle which was insured by State Farm. Vail was driving when the vehicle was involved in a rollover accident that resulted in Heath's death. The Montana Supreme Court previously held in Freyer I, based upon the language of the policy's "Limit of Liability" clause, that there was coverage for Alicia's claim for derivative damages stemming from the death of her father under her own "Each Person" policy limit of \$50,000, contrary to State Farm's coverage position that all damages arising from Heath's death were covered only on the Each Person policy limit of \$50,000 applicable to him.

After remand, State Farm paid the contested coverage amounts. The personal representative of the estate of Heath and the conservator of the estate of Alicia (a minor), and Vail brought claims against State Farm under several theories for wrongful denial of coverage for Alicia's derivative claims. The District Court again granted summary judgment to State Farm on all of those theories, which appellants challenged on appeal (Freyer II).

The first issue the Montana Supreme Court addressed was whether the District Court erred by concluding that State Farm had not breached the insurance contract when it failed to indemnify Vail for Alicia's derivative claims because State Farm had a "reasonable basis in law" to challenge coverage for those claims. The appellants asserted derivative claims for damages sustained by Alicia arising from her father's death caused by Vail's negligent driving and argued for coverage under State Farm's policy. State Farm did not challenge appellants' assertion that the value of Alicia's derivative claims exceeded the \$50,000 "Each Person" policy limits. Montana's Supreme Court had previously held that State Farm incorrectly interpreted its policy by applying a single "Each Person" coverage limit and refusing further payment for Alicia's claims. Therefore, State Farm breached its duty to indemnify Vail to the proper limits of its policy against Alicia's derivative claims, and it breached the insurance contract by doing so. A breach of contract claim could not be obliterated by the reasonableness of the breaching party's action. Therefore, the Supreme Court found that the District Court erred by permitting State Farm to raise a "reasonable basis in law" defense to appellants' breach of contract claims.

The next issue the Montana Supreme Court addressed was whether the stipulated judgment between Vail and the personal representative/conservator for \$2.7 million was an appropriate measure of damages for breach of the insurance policy. The Montana Supreme Court found the stipulated judgment was not an appropriate measure of damages. State Farm had provided a defense subject to a reservation of rights and filed a simultaneous declaratory judgment action. Therefore, the Montana Supreme Court found that State Farm did not breach its duty to defend and thus, could not be held liable for the entire \$2.7 million. Instead, State Farm had refused to indemnify based upon its coverage position.

The Montana Supreme Court found when an insurer defends the insured against the claim and challenges coverage in a separate declaratory judgment action, a stipulated settlement that relieves the insured of any financial stake in the outcome of the case does not represent the damages within the contemplation of the parties when they entered into the insurance policy. Neither party would have expected such damages to result from a breach of the policy. The Court pointed out the insured has little incentive to minimize the settlement amount in negotiating the stipulated judgment. There is no assurance that a stipulated judgment represents a proper calculation of the actual damages incurred by way of a breach. State Farm had tendered the full \$50,000 "Each Person" coverage limit to Heath's personal representative and did not breach its duty to indemnify Vail for Heath's claims. The bulk of the stipulated judgment did not represent the true measure of damages resulting from State Farm's breach of its duty to indemnify Vail for Alicia's claims. Because State Farm pursued the path that the Montana Supreme Court repeatedly advises insurers to take if there is a coverage question – defend the insurer and file a declaratory judgment action to discern coverage – it did not criticize State Farm in this case for taking this course or hold it liable for the amount of the stipulated judgment since it defended its insured while disputing its duty to indemnify. The Court did remand in order to determine what damages, if any, were recoverable for the breach of the contract.

The Montana Supreme Court next addressed whether State Farm committed bad faith or breached the covenant of good faith and fair dealing. The Court affirmed summary judgment entered on behalf of State Farm for those claims. State Farm had not breached its duty of good faith and fair dealing to Vail by refusing to accept the settlement offer from the conservator to settle Alicia's claims for \$50,000. The Montana Supreme Court agreed with the District Court that State Farm had a reasonable basis in law to contest coverage. The Montana Supreme court reiterated that an insurer's error in judgment in not settling a case within the policy limits is not, in and of itself, sufficient to impose liability upon the insurer for recovery in excess of the limits. Rather, whether an insurer acts in good faith must be determined on a case-by-case basis. Moreover, an insurer does not act in bad faith, at least in Montana, when rejecting settlement they have a reasonable basis in law or fact to contest either the claim or the amount of the claim.

The Montana Supreme Court surveyed the landscape of the law at the time of the rejection of the settlement demand to determine whether State Farm had a reasonable basis in law for its rejection. Although the determination whether a party has acted reasonably is typically a question of fact for the jury, whether an insurer was reasonable in its interpretation of legal precedent in its coverage determination was a question of law. Reasonableness is a question of law for the court to determine when it depends entirely on interpreting relevant legal precedents and evaluating the insurer's coverage defense under those precedents.

The Montana Supreme Court determined that the legal landscape across numerous jurisdictions supported State Farm's decision to contest coverage for Alicia's derivative claims. However, that did not end the inquiry. State Farm was required to analyze the claim in light of the specific language of the Limit of Liability clause in Vail's policy. The Court analyzed that language and agreed State Farm had reasonably interpreted it. Because under Montana common law, the insurer cannot be held liable for bad faith in denying a claim the insurer had a reasonable basis for contesting the claim, the Court found State Farm had not breached the covenant of good faith and fair dealing with Vail, or committed bad faith by failing to settle with the conservator.

Finally, the Montana Supreme Court concluded that State Farm had not violated Montana's UTPA because the Act specifically states that an "insurer may not be held liable under this section if the insurer had a reasonable basis in law or in fact for contesting the claim or the amount of the claim, whichever is an issue." Based on the plain language of the UTPA, State Farm's reasonable basis in law for contesting the claim resulted in a finding of no liability. Because the Montana Supreme Court found State Farm had a reasonable basis for its Limit of Liability clause interpretation, the Montana Supreme Court affirmed summary judgment in favor of State Farm on the UTPA claims.

The Montana Supreme Court took the opportunity in this case to clarify and set forth many propositions of law, which I anticipate will provide precedential value in future Montana bad faith cases. The Montana Supreme Court seemed to side with State Farm largely because State Farm had defended its insured, filed a declaratory judgment action and then contested coverage relating to its duty to indemnify. If State Farm had not defended its insured, the result may have been much different; the Montana Supreme Court seemed to indicate that State Farm may have been liable for the entire \$2.7 million stipulated judgment as consequential damages flowing from State Farm's breach of its duty to defend.

By Aaron French

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