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BAD FAITH BLOG

Excess Insurer's Mistake About its Applicable Limits, Absent Bad Faith, Limited its Exposure to Contract Damages

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Summary: A tanker truck spilled 6,380 gallons of gasoline, which flowed underneath the highway and beneath the property of multiple homeowners. This case involved the available amount of coverage under primary and excess policies that included both commercial general liability and auto liability coverages. The primary carrier quickly exhausted its $1,000,000 Auto limit through clean-up costs, and when suit was filed the primary carrier tendered the defense to the excess carrier. Excess carrier defended until its $4,000,000 "Per-Occurrence" limit was exhausted and then, believing its applicable limits had been exhausted, re-tendered defense back to the primary carrier. A declaratory judgment action ensued over the amount of available primary and excess coverage. The insureds entered into a "covenant not to execute" agreement that resulted in a stipulated judgment in excess of $13,000,000.

Westchester Surplus Lines Insurance Company v. Keller Transport, Inc.

The Court held that the insurers were wrong about the amount of coverage but that there was no breach of duty to defend. Hence, the insurers were not responsible for stipulated judgment that resulted from the covenant not to execute.

The Supreme Court noted in its analysis that, if an insurer breaches its *duty* to defend, it is responsible for both defense costs and judgments. It concluded that this standard applies where an insurer decides to assume an insured's defense even where there is no actual duty to defend. Significant to the Court's holding that the insurers were not bound by the amount of the judgment in this case, however, was that the insured was at all times being afforded a defense by the insurer. Although there was a delay in resumption of payment of defense costs, that delay was not a breach of the duty to defend. In addition, the stipulated judgments took place eight months after the insurer resumed paying the defense costs. Because there was no breach of the duty to defend, the insurer was not responsible for the judgment in excess of the insurers' policy limits.

The Court concluded that the insureds were not "improperly abandoned." Consequently, they were not justified in taking steps to limit their own personal exposure by entering into a covenant not to execute that resulted in a stipulated judgment. Specifically, the Court concluded that a stipulated judgment will not be enforced against an insurer where the insurer has conceded coverage and defended its insured, and where "there has been no finding of bad faith against the insurer," though there do not appear to have been any bad faith claims asserted in this case.

The Supreme Court did not include much analysis regarding bad faith in this case, probably because it first concluded that there had been no breach of the duty to defend. However, the Court does appear to have made a subtle, yet significant distinction between a traditional judgment and a stipulated judgment. The Supreme Court held that, if an insurer breaches the duty to defend, it is responsible for "defense costs and judgments," presumably regardless of an insurer's policy limits *Id*. at 473. However, it also held that a stipulated judgment is only enforceable against an insurer if the insurer is found to have committed bad faith. *Id*. at 474. Hence, the significance of the Supreme Court's holding in this case appears to be that an insurer can be held responsible for a judgment entered against its insured in excess of its policy limits if it breaches the duty to defend, but it will only be responsible for an excess stipulated judgment if, in addition to breaching the duty to defend, it is also found to have committed bad faith. Creating such a distinction seems to indicate a disfavor, in Montana, of *stipulated* judgments that result from "covenant not to execute" agreements.

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