SANDBERG PHOENIX

BAD FAITH BLOG

No Bad Faith Claim – No Problem Says Missouri Supreme Court

AUTHOR: SANDBERG PHOENIX

Summary: The Missouri Supreme Court affirmed the judgment against a liability insurer for extra-contractual damages in a declaratory judgment action originally filed by the insurer to determine coverage and defense obligations. The insurer was not allowed to challenge the reasonableness of its insured's court-approved settlement and the judgment entered against the insurer for extra-contractual damages was upheld despite there being no bad faith claim asserted in the declaratory judgment action filed by the insurer.

Columbia Casualty Company v. HIAR Holding, LLC, 2013 WL 4080770

The insured, HIAR Holdings, LLC, operated a hotel in St. Louis. The insured sent unsolicited facsimiles in 2001. In 2002, a class action lawsuit was filed under the Telephone Consumer Protection Act ("TCPA") seeking injunctive relief and statutory damages. After the suit was filed the insured tendered the defense to the insurer; however, the insurer rejected the tender and refused to defend the suit. Approximately one year later the insured again requested a defense and the insurer again refused the tender. The insurer asserted a no coverage position under the policy.

Ultimately, the class representative made a formal offer on behalf of the class to settle the claims within the liability limits of the insurer's policy, which were $1,000,000 per occurrence and $2,000,000 in the aggregate. The insurer declined the offer and did not participate in any settlement negotiations.

The insured defended itself for approximately 5 years before settling the case for $5,000,000. Pursuant to the settlement, the insured agreed not to contest liability and damages in the amount of $5,000,000. The agreement further provided for the entry of a judgment against the insured for that amount and in exchange the class agreed that it would not enforce the judgment against the insured and would instead limit its recovery to any insurance policy proceeds. Additionally, the insured assigned all of its rights under the policy to the class, except those rising out of the duty to defend.

The court conducted a hearing at which it found the proposed class action settlement was reasonable and granted preliminary approval. After only 488 claim forms were retuned, and no objections were filed, the trial court held a final approval hearing. The court approved the settlement and determined that it was a fair and reasonable amount and not a product of collusion. The court also approved the assignment to the class of the insured's claims against the insurer.

The class then filed an equitable garnishment action against the insurer seeking the $5,000,000 settlement amount plus interest, which together totaled approximately $8,400,000. The insurer denied any coverage and filed a declaratory judgment action. The garnishment action was stayed pending resolution of the declaratory judgment action. The insurer then settled the duty to defend portion of the case, but continued to contest the application of coverage to the settlement amount. (Unfortunately for the insurer, its duty to defend settlement came too late.) The trial court granted summary judgment to the class and against the insurer finding that the insurer acted unreasonably and in bad faith in handling the insured's claim.

The Missouri Supreme Court held, relying heavily on Schmitz v. Great American Assurance Co., 337 S.W3d 700 (Mo. banc 2011), that when an insurer has an opportunity to control and manage the litigation and fails to do so, the insurer is bound by the liability determination. The Supreme Court further held that an insurer may only challenge the reasonableness of damages if the settlement has not been the subject of a judgment by a trial judge approving its reasonableness. The Supreme Court reasoned an insurer that wrongly refuses to defend is liable for the underlying judgment as damages flowing from its breach of the duty to defend.

The Missouri Supreme Court, in a unanimous decision, also held that the insurer's policy limits do not apply to limit coverage; instead, the insurer was liable for the full amount of the $5,000,000 settlement judgment plus all interest. The Supreme Court rejected the insurer's argument that only a bad faith claim could result in extra-contractual damages and that no bad faith claim had been asserted in the underlying case. The trial court found (and the Supreme Court agreed) that the insurer's refusal to defend its insured put it in a position to indemnify even though no bad faith was asserted. The insurer's wrongful refusal to defend put the insurer in a position to indemnify its insured for all damages flowing from its breach of duty to defend. The Supreme Court specifically noted that the insurer wrongfully denied coverage, refused to provide a defense, and refused to engage in settlement negotiations despite having the opportunity to do so. Therefore, the insurer could not avoid liability for the "settlement judgment."

The latest Missouri Supreme Court ruling provides many lessons for insurers who write insurance in the State of Missouri. Insurers need to be extremely cautious in denying coverage because the consequences can be extremely harsh. Most significantly, the insurer could be exposed to an extra contractual judgment even though no bad faith claim had been alleged. By its decision, the Missouri Supreme Court has called into question decades of bad faith precedent in the State of Missouri. It appears no longer is it necessary for a court to find that an insurer acted in bad faith, i.e. unreasonable but more than negligent, in order to be exposed to extra-contractual damages.

Further, insurers need to be increasingly aware of settlement agreements and understand they cannot simply deny coverage and close their file. Instead, they need to be aware of the potential for these types of agreements and understand the warning signs that such an agreement is being contemplated or entered into between a policyholder and the claimant. For instance, usually insurers are given multiple opportunities and receive multiple demands to either defend or settle within the policy limits. If they continue to refuse, it is likely there has been (or soon will be) a discussion between the claimant and the policyholder about entering into a settlement agreement whereby the claimant will only pursue policy proceeds instead of the insured's assets. These types of agreements have been upheld and are essentially beyond challenge if a court enters a judgment based upon evidence (even if the liability and damages evidence is uncontested).

These warning signs must be treated very seriously and the insurer should consider filing a declaratory judgment action sooner rather than later. However, in this case the filing of the declaratory judgment action after the denial did not make a difference. When faced with these situations where coverage is not necessarily clear, insurers should consider issuing a reservation of rights simultaneously with filing a declaratory judgment action to both preserve its coverage defenses and to better protect itself from an extra-contractual verdict.

By Aaron French

French, A
Image not found or type unknown