SANDBERG PHOENIX

BAD FAITH BLOG

Eighth Circuit Finds No Bad Faith by Primary Insurer Under Missouri Law in Insurer Versus Insurer Dispute

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Summary: This case is a dispute between an excess and primary insurer, both of whom insured a trucking company whose tractor trailer was involved in a fatal traffic accident. The parties injured in the accident sued the trucking company and obtained a jury verdict, which exposed the excess carrier to a $17 million liability. The excess carrier sued the primary carrier alleging bad faith for failing to settle the underlying claim within the policy limits. The district court granted primary insurer's Motion for Summary Judgment and the Eighth Circuit affirmed.

American Guarantee and Liability Insurance Company v. United States Fidelity & Guaranty Company; TIG Insurance Company, Eighth Circuit (No.-10-2275)

The primary insurer insured the trucking company under a policy with limits of $5 million. The primary policy was a fronting policy. Fronting policies are policies in which the insured's deductible is equal to the policy limits. A fronting policy protects the public in the event the insured entity becomes insolvent. These policies are frequently used by trucking companies to stay self insured while still complying with the financial responsibility laws in the state in which they operate. In this case, the insured agreed to indemnify the primary insurer in the event the primary insurer paid any amounts payable under the policy. The insured secured its indemnity obligation with $187 million in collateral which could be drawn upon in the event that the insured became insolvent or bankrupt, which is what happened.

Before the underlying trial, the insured filed for bankruptcy and was dissolved. The automatic stay was lifted as to the underlying lawsuit on the condition that any recovery from the insured would be limited to the available insurance coverage. A pre-trial global mediation was held and the insured participated in the mediation through its third party administrator (TPA) which handled all of the insured's claims on behalf of the primary insurer. The mediation ended in all defendants settling except for the insured and one other defendant. During the mediation, the plaintiffs demanded $5 million from the insured and the insured rejected this demand.

The only other remaining, non-settling defendant settled with the plaintiffs before the tort case. The total settlement amount that the plaintiffs received prior to trial totaled nearly $5.1 million. This meant the plaintiffs had to recover a verdict exceeding $5.1 million to recover anything from the primary insurer.

In addition to the primary policy, the insured carried excess insurance. A verdict would need to exceed $10.1 million to exhaust the primary insurance fronting policy, and a verdict exceeding $13.1 million was necessary to recover anything from the excess insurer (the first layer of excess insurance was $3 million through an affiliate of the insured). None of the insurers claims managers, or defense attorneys involved in the underlying lawsuit, estimated the insurance exposure to be more than $13.1 million, and all believed the risk of a jury finding the insured responsible for more than $13.1 million was very low to non-existent.

Like the other claims managers involved, the excess insurer's claims handler did not believe the value of the remaining claim would expose the excess policy. Nevertheless, the excess insurer asked the TPA to settle the remaining claim within the primary policies limit of $5 million. Settlement negotiations continued during trial; however, the insured never demanded that its primary insurer settle within the policy limits and settlement was never reached.

Of course, this blog post is being written because the jury returned a verdict totaling $46.06 million. After subsequent reduction and adjustment for set off and negotiations, the plaintiff eventually settled for $22 million in "new money." Of that amount, $5 million was paid by the primary policy and the excess insurer ultimately faced an exposure of $17 million.

The primary insurer filed a Declaratory Judgment Action against the excess insurer in Federal District Court in Missouri. The primary insurer claimed its payment of $5 million terminated all of its obligation with respect to the underlying lawsuit.

The excess insurer filed an action against the primary insurer, its claim manger, and the TPA in the Federal District Court in the State of Washington alleging the primary insurer failed to settle the plaintiff's wrongful death lawsuit in bad faith. The excess insurer sought $17 million in damages from the primary insurer. (The excess insurer was able to choose Washington because the insured had operated its nationwide trucking company out of Washington before its dissolution.)

Under the "first to file" rule, the Washington Court agreed the dispute between the two insurance companies should be litigated in Missouri and transferred the action where it was consolidated with the primary insurer's pending Declaratory Judgment Action. The District Court made a determination that Missouri law would apply as requested by the primary insurer and then granted the primary insurer's motion for summary judgment.

On appeal, the excess insurer contended the district court erred in applying Missouri law rather than Washington law. After applying Missouri's choice of law rules to determine which states law should govern, the Eighth Circuit agreed that Missouri's law applied. The Eighth Circuit found the dispute had more contacts with Missouri than with Washington for the following reasons: 1) any injuries arising from the bad faith failure to settle claim did not occur in Washington because the insured was dissolved and no longer existed when the Missouri jury rendered a verdict in favor of the plaintiffs'; 2) the conduct causing the injury occurred in Missouri where most of the settlement negotiations took place or should have taken place; 3) neither the excess insurer or the primary insurer were incorporated in either Washington or Missouri; and 4) Missouri was the place where the relationship between the two insurers was centered because Missouri was where the underlying litigation occurred.

The Eighth Circuit also affirmed the district court's determination that the excess insurer's bad faith claim failed because the insured never made a demand for the primary insurer to settle the underlying litigation within the primary policy limits. One of the necessary elements of bad faith failure to settle claims in Missouri is that the insurer has demanded that the insurer settle the claim brought against the insured. Missouri recognizes two exceptions to this general rule. One exception, which is inapplicable here, is when the insurer denies coverage and refuses to defend.

The second exception is when the insured is not informed by the insurer of settlement offers. The excess insurer argued there were genuine issues on fact of whether this exception applied. The excess insurer contended the primary insurer and the TPA failed to keep the insured advised of the settlement offers. The Eighth Circuit found that the record showed that the insured was advised of settlement demands, but elected not to settle because it believed its exposure was much less than the plaintiffs wanted. As a consequence, it never demanded that the primary insurer settle the case within the $5 million policy limits, despite being urged to do so by the excess insurer.

The excess insurer argued a third exception applied--that no settlement demand was essential when the primary insurer reserves to itself the exclusive right to make settlements. The excess insurer argued the exception applied here because of the insured's bankruptcy. Therefore, the TPA exercised the exclusive right to settle because the insured had no financial interest in the underlying litigation and did not have authority to demand the primary insurer settle the claims within the policy limits. Assuming Missouri would even recognize this third exception, the Eighth Circuit concluded that the insured had a financial interest in the outcome because the primary policy was a fronting policy secured with the insured's collateral, which became part of the bankruptcy estate. When the automatic stay was lifted, it exposed the insured's collateral up to the $5 million retention limit under the primary policy.

The Eighth Circuit did not address the excess insurer's argument that Missouri would allow a direct action between insurers when such action is based upon principals of equitable subrogation. In light of the Eighth Circuit's conclusion the bad faith claim failed because the insured never made a demand of the primary insurers to settle, the excess insurer's argument regarding equitable subrogation was not reached. However, the Eighth Circuit did acknowledge Missouri law does not generally allow an excess insurer to bring a bad faith claim in its own name against the primary insurer.

By Aaron French

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