BAD FAITH BLOG

Primary v. Excess Wars Continued

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Summary: An excess liability insurance carrier filed a state court declaratory judgment action seeking a declaration that a primary liability insurer was obligated to pay the entire judgment against the insured, as well as prejudgment interest and costs. After removal to federal court, the primary insurer counterclaimed seeking a declaratory judgment that the excess carrier was liable for equitable indemnity and equitable subrogation. The district court ruled that the primary insurer had a claim for equitable subrogation (not equitable indemnity), but that jury questions remained regarding whether the excess insurer had unreasonably refused to settle the underlying personal injury action within its policy limits.

American Alternative Insurance Corp. v. Hudson Specialty Insurance Co. 938 F.Supp.2d 908 (C.D. Ca. 2013)

See our recent blog discussed a Western District of Missouri case in which the excess insurer was allowed to pursue a recovery for bad faith failure to settle damages against a primary insurer. In this case, the U.S. District Court for the Central District of California recognized the primary insurer's right to recover damages (potentially bad faith damages) from an excess carrier.

The accident in the case arose when Minuteman Parking was providing valet parking services at a casino in Riverside County, California. The car operated by a Minuteman employee hit Tory Fretz, which led to hospitalization, surgery, and other care and treatment. Both American Alternative Insurance and Hudson Specialty Insurance covered Minuteman. Hudson's primary limits were for $1 million, as well as supplementary payments for costs taxed and prejudgment interest under certain circumstances. The American Alternative coverage was for $4 million after exhaustion of the primary policy. The excess policy provided that American Alternative would "assume charge of the settlement or defense of any claim or suit against the insured" whenever the underlying limits of liability had been exhausted. Fretz sued and obtained a Judgment against Minuteman which exceeded Hudson's primary policy limits.

Each carrier blamed the other for the amount of the Judgment and each carrier sought from the other extra-contractual damages described as damages from a breach of the implied covenant of good faith and fair dealing and/or consequential damages. After suit was filed, Hudson assigned defense counsel who projected a settlement range between $500,000 and $700,000. About nine months after suit was filed and a month after receiving the evaluation report, Fretz mailed Hudson a statutory offer to compromise for the $1 million liability limits. Hudson rejected that offer 30 days later and, at the same time, notified American Alternative of the claim, the offer, and the rejection.

Nearly nine months later, defense counsel submitted a report from a neuroradiologist whose opinion was that Fretz had sustained a permanent brain injury which could “impair emotional function and personality” while also noting that the hospital medical records immediately following the accident did not suggest a significant brain injury. A month later, defense counsel reported plaintiff’s neuropsychologist testified that Fretz was psychologically impaired and reported that family and friends had observed “profound behavioral changes.” The lifetime medical care for Fretz was projected to be nearly $905,000. That report was immediately followed by a settlement demand of $3 million, followed by defense counsel’s significantly increased settlement value range $3.1 and $3.25 million.

Shortly thereafter, Hudson made its $1 million policy limits available and American Alternative made available $250,000 to counter the $3 million settlement demand. That demand was immediately withdrawn and increased to $5 million. Defense counsel passed along a statement by Fretz’ attorney that Fretz would likely settle for $3 million. American Alternative set a settlement reserve of $3 million.

During trial the President of Minuteman demanded an immediate settlement within limits and American Alternative authorized up to $5 million to settle the case. However, the verdict for $6.5 million was returned before that amount was offered. The total Judgment (including costs and prejudgment interest exceeding $680,000) was for slightly more than $7.2 million. A settlement was achieved for the amount of the Judgment about 30 days after Judgment was entered. Hudson contributed its policy limits plus $219,000 with American Alternative paying the rest of the Judgment and Hudson paying all defense costs to defend Minuteman through trial.

The district court ruled that Hudson could not pursue a counterclaim for equitable indemnity against American Alternative because there was no contractual relationship between the two insurers. However, the court noted that California’s implication of the covenant of good faith and fair dealing requires every insurance company “to accept a reasonable offer of settlement within the insurer’s policy limits when there is a substantial likelihood of recovery in excess of those limits.” The covenant of good faith and fair dealing runs to the insured from both primary and excess insurance carriers.

Even though traditionally that covenant ran from the carriers to their insureds only, for at least 20 years California has allowed primary and excess insurance carriers to recover from one another "for their bad faith refusal to accept a reasonable settlement offer under the theory of equitable subrogation." (Citing *Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 21 Cal.App.4th 15856, 1600, 26 Cal.Rptr.2d 762 (1994).) Since at least 1991, California courts recognized an equitable subrogation recovery by primary insurers against excess insurers. Such an equitable subrogation recovery was allowed in *Diamond Heights Homeowners Assn v. Nat'l Am. Ins. Co.*, 227 Cal.App.3d 563, 580, 277 Cal.Rptr. 906 (Ct. App. 1991), where the excess insurance company "arbitrarily vetoed a reasonable settlement, and forced the primary insurer to proceed to trial and bear the full costs of defense." The U.S. District Court found that if "an excess insurer, like a primary insurer, fails to accept a reasonable settlement offer within its policy limits, it may be liable to the other insurer for any excess liabilities. This parallel liability ensures that the 'burden for a loss [is] on the party ultimately liable or responsible for it and by whom it should have been discharged.'" *Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 65 Cal.App.4th 1279, 1296, 77 Cal.Rptr.2d 296 (1998).

American Alternative sought to escape exposure by arguing that there was no right to equitable subrogation claims seeking only a recovery for costs. Citing to the *Diamond Heights* case the court rejected that argument. The court ruled that if American Alternative acted unreasonably in refusing the settlement offers then it could be liable for "any excess liability Hudson paid, including defense costs and costs and interest on the Judgment."

American Alternative defended against the claim that it unreasonably refused to settle the Fretz action giving rise to Hudson's equitable subrogation claims for costs and other payments on grounds that American Alternative had no duty to pay "the defense costs and costs taxed against Minuteman." The court rejected that defense because equitable subrogation claims are not bound by contract terms.

Nevertheless, the court found that there was triable issue "whether [American Alternative] failed to reasonably settle the Fretz action prior to trial and within its $4 million policy limit." The court recognized the general rule in California that questions whether an insurance company "has acted unreasonably, and hence in bad faith, in rejecting a settlement offer is a question of fact to be determined by the jury." (Citing *Walbrook Ins. Co. v. Liberty Mut. Ins. Co.*, 5 Cal.App.4th 1445, 1454, 7 Cal.Rptr.2d 513 (1992).) The District Court ruled that it was obvious that there were several settlement offers which American Alternative could have acted upon and prevented the excess judgment, but further found that he could not "find as a matter of law that [American Alternative] reasonably refused Fretz's settlement offers under $4 million." The District Court further ruled that there were triable issues of fact regarding American Alternative's reasonable reliance on defense counsel's calculations and evaluations, and whether it was reasonable to reject "Fretz's $3 million settlement offers, while setting aside reserves above $3 million." Based upon those factors, the District Court was unwilling to grant summary judgment on that issue. Instead those factors prevented the District Court "from concluding that Hudson is liable as a matter of law for the defense costs incurred during trial and for the $210,289 in costs and prejudgment interest it paid as part of the Judgment."

The lesson for both primary and excess carriers in California is to make sure that they carefully and appropriately evaluate each case and, whenever it appears reasonable that an excess verdict will occur absent a settlement within limits, the excess and primary carriers need to cooperate to ensure an appropriate and timely settlement. In the alternative, they need to settle with the plaintiff, protect their insured, and then proceed against the non-settling insurer.

By Anthony Martin

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