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PERSPECTIVE

Bad faith spurs liability for excess settlements

By Fiona A. Chaney

In *Ace American Insurance Co. v. Fireman's Fund Insurance Co.,* 2016 DJDAR 8044 (Aug. 5, 2016), the California Court of Appeal addressed an issue of importance to insurers and insureds alike — the liability of a primary insurer for failing to settle a suit against its insured when the suit is later settled for a higher amount. This decision actually involved a battle between two insurers. The primary insurer contended that it could not be liable for a settlement in excess of a prior settlement opportunity because the higher amount was the result of a settlement, not a judgment against its insured. In this case, it was an excess insurer that disagreed — because it had to pay a portion of the increased amount.

Under long-established California law, the implied covenant of good faith and fair dealing requires insurers to accept reasonable settlement demands within policy limits. *Comunale v. Traders & Gen. Ins. Co.,* 50 Cal. 2d 654, 659 (1958). If an insurer breaches this implied covenant by unreasonably refusing to settle, an insured may sue its insurer to recover damages proximately covered by the insurer's breach. *PPG Industries Inc. v. Transamerica Ins. Co.*, 20 Cal. 4th 310, 312 (1999).

In the last 15 years, this doctrine of the good faith duty to settle has expanded in favor of insureds. In 2001, the California Supreme Court held: "If an insurer fails to accept a reasonable settlement offer within the policy limits, and the judgment exceeds the policy limits, the insurer risks liability for the entire judgment and any other damages incurred by the insured. Moreover, the insurer may not consider the issue of coverage in determining whether the settlement is reasonable." *Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal. 4th 489, 502 (2001).

More recently, in *Howard v. American National Fire Insurance Co.*, 187 Cal. App. 4th 498 (2010), a dispute regarding coverage for molestation claims against the Roman Catholic Bishop of Stockton, an insurer argued (1) there was never a settlement demand within its $500,000 policy limit so it alone could not have settled the underlying case; (2) the settlement demands were unreasonably high; and (3) the insured was never exposed to personal liability in excess of the aggregate limit of all his insurance policies and thus unharmed by any failure to settle.

The *Howard* court rejected all of these arguments and instead recognized that because there was a settlement demand "well within" the limits of the multiple insurers on the risk, the insured did have an opportunity to settle. The court confirmed that "when multiple insurance policies provide coverage, each insurer's obligation is to cover the full extent of the insured's liability up to its policy limits. [The insurer] did not respond to the settlement demand with its policy limits and, had it and other insurers done so, could have settled the litigation." The court also made clear that all of the insurers owed a duty of good faith and fair dealing to the insured: "[T]he law cannot excuse one insurer for refusing to tender its policy limits simply because other insurers likewise acted in bad faith. If this were not the case, insurers on the risk could simply all act in bad faith, thus immunizing themselves from bad faith liability." Indeed, the court noted that "an insurer's wrongful failure to settle may be actionable even without rendition of an excess judgment."

Last week, *Ace* crystalized this last point — no excess judgment is required for an insurer to be liable for bad faith. In 2011, a special effects worker, John Franco, was seriously injured on the film set of "Green Lantern" after a truck rollover accident caused debris to go flying. Franco and his wife sued Warner Brothers Entertainment Inc. and its related entities for damages and loss of consortium. Fireman's Fund provided primary insurance with a $2 million limit and Ace provided an umbrella policy with a $3 million limit. In 2012, the Francos made settlement demands within the primary insurer's limits but Fireman's Fund refused to pay the demands. Several months later, the Francos settled their lawsuit "for an amount substantially in excess" of the Fireman's Fund limits. Both Fireman's Fund and Ace contributed to the settlement. Ace then sued Fireman's Fund for equitable contribution and breach of the covenant of good faith and fair dealing.

Ace clearly confirms that if an insurer breaches its duty to settle, then it may be liable for any greater amount paid to resolve a suit against its insured — even if the greater amount is the result of a settlement rather than a judgment.

In reliance on *RLI Insurance Co. v. CNA Casualty of California*, 141 Cal. App. 4th 75, 82 (2006), Fireman's Fund argued that an excess insurer may only sue for equitable subrogation if there has been a judgment against the insured that exceeds the limits of the primary policy and that because there was no judgment, it could not be liable. The court rejected this argument and favored the conflicting decision in *Fortman v. Safeco Insurance Co.*, 221 Cal. App. 3d 1394 (1990), which held that an excess judgment was not a prerequisite to an equitable subrogation claim, as long as the excess insurer demonstrated that it actually paid an amount in excess of the primary insurer's policy limits.

The *Ace* court also rejected Fireman's Fund's argument that "a conventional settlement between the parties, which is not approved by the court and does not result in even a nominal judgment, does not establish the damages required to settle a claim" and that "without a judgment, there is nothing to establish whether and to what extent the case was worth more than the primary limits." Instead, the court held that there was no reason to hold that the insured (or its assignee, the excess insurer) "must suffer that loss with no remedy simply because the case reached an eventual settlement instead of being litigated through trial." In so holding, the court confirmed California's policy of encouraging settlements and explained that its decision "protects insureds, because insurers whose mishandling of settlement offers causes damages will be liable for the losses they cause." Thus, the court held that "where the insured or excess insurer has actually contributed to an excess settlement, the plaintiff may allege that the primary insurer's breach of the duty to accept reasonable settlement offers resulted in damages in the form of the excess settlement."

While *Ace* was decided in the context of a subrogation dispute between two insurers, its implications are much broader. *Ace* clearly confirms that if an insurer breaches its duty to settle, then it may be liable for any greater amount paid to resolve a suit against its insured — even if the greater amount is the result of a settlement rather than a judgment. Thus, insurers cannot avoid liability for amounts in excess of their policy limits — whether to their insured or an excess insurer — simply because a lawsuit was resolved by a settlement rather than tried through a final judgment.

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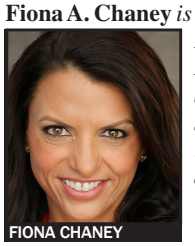
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