The Handling of Third Party Claims in Missouri - Episode #120

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John Czuba:: Welcome to the "Insurance Law Podcast," the broadcast about timely and important legal issues affecting the insurance industry. I'm John Czuba, Managing Editor of *Best's Directory of Recommended Insurance Attorneys*.

We're pleased to have with us today attorneys Aaron French and Phil Graham from the law firm of Sandberg Phoenix & von Gontard P.C. in St. Louis, Missouri. Aaron is a shareholder and joined the firm in 2003. He specializes in representing insurance carriers in coverage disputes and extra contractual litigation. He also serves as a business litigation practice group leader.

Phil Graham is a shareholder with more than 20 years of experience to the firm's Business Litigation and Products Liability Practice Groups.

Phil's practice includes matters such as enforcement and defense of contract rights and other contractual matters, business torts including fraud, negligent misrepresentation, tortious interference with business relations, trade secrets, and other intellectual property.

They both contribute to the blog www.badfaithblog.net. We're very pleased to have you both with us today.

Aaron French: Thanks, John. Happy to be here.

Phil Graham: Thank you, John, very much. Honor to be here.

John: Today's topic is on the handling of third party claims in Missouri. Aaron, we're going to start the questioning with you today. Missouri is quickly becoming known as a risky state for insurers handling third party claims. Can you tell us why that is?

Aaron: There's a variety of reasons. I think the main reason is there have been a number of court decisions from our appellate courts, and especially our Missouri Supreme Court, over the last few years that have been very pro policyholder.

In fact, there was a recent "Missouri Lawyers Weekly" study that showed between the years 2001 and 2012 the Missouri Supreme Court, out of 20 cases, decided only four of those cases in favor of the insurance companies on coverage issues and bad faith issues.

Primarily there are three cases, a trilogy of cases, coming out of our Missouri Supreme Court. The *Schmitz versus Great American* case from 2011. The *Columbia Casualty versus Higher Holdings* case from 2013. The *Scottsdale Insurance versus Addison Insurance Company* case out of 2014.

Which have really expanded the law here in Missouri and given a number of rights to policy holders and led to a proliferation of garnishment actions – which we'll talk about under our statute 537.065 – as well as bad faith claims in the last few years.

John: Phil, what options does a carrier have in Missouri with regard to the duty to defend when there's an actual or potential defense to coverage?

Phil: I'd be glad to address that for you. It's like this, real quickly, this is obviously a critical decision point for the carrier when they're getting involved. It always is worth remembering that, of course, the duty to defend is broader than the duty to indemnify.

In Missouri the insurer needs to look at both the facts alleged in the complaint, and also those that are known or recently ascertainable to it outside of the complaint. Assuming that the carrier has done its analysis and looked at it, and believes it has a real or at least potential defense to coverage, there are four basic options.

They can accept the defense and defend the insured without any reservation of rights. The caveat there is that, if they do that, that also triggers a duty to indemnify. There's a need to be careful and carefully analyze that decision.

Timing is also important. Prompt investigation and assistance from coverage counsel when necessary to make decisions about coverage defenses is important. It's important to decide those things quickly and early as possible. Every case, of course, is different. Every circumstance is different.

Second option is to defend the case under a reservation of rights. I think we'll address that in a little more detail later on. There are a couple of points to consider here when defending under a reservation of rights. It is not necessarily a magic or silver bullet in Missouri. I think we're going to talk about this a little more later, but the insured can reject that defense in Missouri.

The insurer may not be able to technically control the defense anymore in some situations and circumstances if they're defending under a reservation of rights in Missouri.

The third option is defend under a reservation of rights and file a declaratory judgment action right away. This gives the carrier some degree of extra protection as well as a more immediate coverage determination.

The fourth option, assuming that the facts and the circumstances and law support it, is to disclaim or deny coverage, and no defense is provided. This is obviously an area where a carrier needs to be careful. It needs to clearly and carefully evaluate all the issues before making that type of a decision on the defense.

John: Aaron, how specific and certain does a reservation of rights letter need to be, and can an insured reject this?

Aaron: I'll take the second part first. Yes, the insured can reject the reservation of rights, a defense with the reservation of rights, under Missouri law. As far as specificity, the court decisions tell us that the reservation of rights letters need to be clear.

They need to try to avoid confusion. They need to inform the insured of the coverage decision as best possible based upon the information that the insurance company has at the time of issuing the reservation of rights letter and after an investigation has been done. The case law in Missouri talks about a number of things that we would advise to be in those reservation of rights letters.

First and foremost, if you're reserving rights, you need to use that phrase, reservation of rights. The letter should identify the policy or the policies at issue. It should quote or at least refer to the relevant policy provisions, especially any exclusions that the insurance company is relying on to potentially bar coverage.

It should refer to the relevant allegations in the complaint. It should identify which claims in the lawsuit, or the complaint may not be covered. It should explain the basis for the insurance company's coverage position as well as possible based upon the information it has. It should advise the insured of any actual or potential conflicts of interest between the insurance company and the insured.

It should reserve the right to withdraw from the defense if coverage is deemed to not be found. It should contain a general reservation of rights including the right to assert other coverage defenses that the insurance company may subsequently learn about during the course of its investigation, or during the discovery in the underlying case. It needs to be pretty specific.

John: Aaron, what are the carrier's options if an insured rejects the reservation of rights defense?

Aaron: This is similar to some of the things that Phil talked about before.

One of the options is to, at the point of rejection of reservation of rights, then reconsider and go ahead and offer to defend without a reservation, understanding that there's a high risk that any coverage defenses that they may have been asserted in that reservation of rights letter may be deemed to be waived or the insurance company may be stopped from litigating those coverage defenses down the road.

The second, another option would be to go ahead and file a declaratory judgment action at that time to seek a ruling from a court on what the insurance company's rights and obligations are under the policy.

Another option would be to just do nothing. But, by doing nothing they run the risks that the policy holder may then decide...which is their right, because once there's been a rejection of the reservation of rights, under Missouri law that is deemed to be a denial.

Once there's been a denial, then the insured, the policy holder, can then enter into an agreement with the claimant or the plaintiff or the plaintiff's attorney under our 537.065 statute, which I think Phil will discuss.

John: Phil, what does the 537.065 statute permit an insurer to do? What are strategies for insurers to avoid them?

Phil: As Aaron just alluded, Section 537.065 comes up when there's either been a disclaimer of coverage or the insured rejects a reservation of rights defense. That's worth highlighting that – Aaron said it, but I'll reiterate it – that in Missouri a rejection by the insured of a reservation of rights defense is treated as a denial of coverage.

If either of those two things happens, then 537.065 can come into play in the right circumstances.

What it permits is that a tortfeasor, or his insurer, or both of them, to enter into an agreement with the plaintiff that basically says, "In the event a judgment is entered against the insured, the tortfeasor or the plaintiff will limit recovery to certain specific assets that are set forth in the agreement."

That can potentially be any asset of the tortfeasor. In the context we're talking about here, it's usually limited to an insurance policy or policies. What happens in the mechanics of this, just real briefly, are that the agreement is entered into.

Then there is typically an expedited bench trial that takes place in which there is no evidence put on in favor of the defendant, and a judgment is entered in favor of the plaintiff, usually for all, very often an amount in excess of the policy limits. Next comes the garnishment proceeding, which can take one of two forms in Missouri. Traditional garnishment or a direct action against the insurer.

The insurer then is left within that garnishment action with its coverage defenses, sometimes with an ability to defend based on the reasonableness of the judgment entered, only if there's been no trial, or trying to prove fraud and/or collusion in entering into the underlying 065 agreement. They are a big concern.

Strategies to try and avoid – we call them 065 agreements, so that's what I'll call them – kind of go along with filing. Insurers cannot be too prepared with respect to these. The main thing to be here is to be cognizant, be aware, and pay attention to Missouri files.

There are certain situations and circumstances to key in on, on these cases. A serious injury or death sometimes with a situation where there may be a very limited liability defense, cases where there are multiple claimants. Even where the injuries themselves may be less severe individually and/or sometimes the defense prospects may be better, but there are still a number of claimants.

Then, also along with that, both those scenarios on limits of insurance that are relatively low in comparison to the exposure risk. Those are the sorts of circumstances that ought to be raising awareness by the insurer if they see them, that it's in Missouri, they see those types of facts. They need to be looking at it carefully.

They need to be thinking about what's going to happen next, and be very aware. Along with that, promptly investigating the underlying claim. Obtaining any necessarily coverage analysis promptly. Getting that underway as quickly as possible. Recognizing that all cases have different facts and circumstances that affects our ability to do that.

Also, considering carefully the relative risks of disclaiming coverage altogether, or defending under a reservation of rights that can be rejected in Missouri, and having that rejection treated as a denial of coverage.

This is a situation where the carrier really wants to make sure they're getting the advice they need to hear from their counsel. Maybe not just what they want to hear, but what they really need to hear in these cases. The watchwords here and the key is awareness, careful evaluation, and real prompt attention to those cases that have those types of considerations.

John: Phil, what are the types of third party bad faith recognized in Missouri? What are the best ways to try to avoid these types of claims?

Phil: There are two types of bad faith recognized in Missouri Common Law. One is the bad faith failure to defend. The other is bad faith failure to settle. Bad faith, of course, is a state of mind that can be proved either by direct or circumstantial evidence.

What is shown really is the intentional disregard for the insured's best interest in an effort to escape the carrier's full responsibility under its policy. Very often you see this framed in terms of the carrier placing its interest ahead of its insured's interests.

There are ways to avoid bad faith claims. It may be a truism and sound obvious, but always act in good faith. How do you do that? Always promptly and fully investigating and evaluating the claimant's damages as quickly as possible under all of the circumstances. Being aware of and recognizing the severity of the claimant's damages. That's important, as well.

Carefully analyzing the probability that a verdict will exceed the available policy limits. This is a point where it's very important to get candid and timely evaluation from defense counsel.

Making sure that you, as an insurer, are getting the feedback you need and reporting you need from your defense counsel, so that you've got the information in your file that enables you to make the decisions that you need to make. That you're not just making the right decision, but that there is information in your file that is going to support the decision that you make.

Another consideration, and way of avoiding a bad faith claim, is evaluating and fully considering every settlement offer. Making sure you're advising the insured of every settlement offer that comes in. Advising the insured if there is a potential of an excess judgment, making sure they know that.

I would say that transparency is the key here. Being transparent with the insured. It's very important to make sure they're informed, they're fully aware. The key takeaways here would be remembering that the insured's interest cannot be subjugated to the carrier's needs or interests. Thoroughly investigating before providing a timely coverage position.

Then, three, just communicate, communicate, communicate. You really cannot, as a carrier, communicate too much with your insured in these types of scenarios that we've outlined. Then, again, being aware. Being aware of the warning signs that we discussed. Those factors to look for if you've got multiple claimants, serious injuries, low limits, and a relatively bad liability defense.

It's not being aware of those situations that can lead to the insured entering into a rollover agreement and/or bringing a bad faith claim against you.

John: Aaron, what does the future hold for insurers in Missouri who are handling third party claims?

Aaron: John, unless there are statutory changes out of our Missouri legislature, it's likely Missouri is going to continue to be a state where insurers are going to need to be very knowledgeable and aware of the issues that we discussed here today.

For Missouri citizens and businesses I fear without some reform, whether it be through the courts or through the legislature, it will lead to higher and higher premiums, or even carriers thinking twice about writing policies in Missouri, unfortunately.

John: Aaron and Phil, thank you both so much for joining us today.

Aaron: Thank you, John.

Phil: Thanks John. I appreciate it.

John: That was attorneys Aaron French and Phil Graham from the law firm of Sandberg Phoenix & von Gontard P.C. in St. Louis Missouri. Special thanks to today's producer Frank Vowinkel.

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