Scope.

This article sets out the law defining the insurer's duty to defend under liability policies in Montana and the insured's rights when the insurer refuses defense. It then specifically focuses on the insured's right to settle the case and assign the insured's rights against the insurer to the claimant in consideration for a covenant not to execute on the insured's assets.

The General Duty to Defend in Liability Policies

The basic coverage agreement or "grant of coverage" in liability policies invariably contains twin promises that the insurer will (1) indemnify the insured for the damages for which the insured is legally liable and (2) defend the suit even if the allegations are groundless, false or fraudulent. The policies generally reserve to the insurer the right and duty to defend as it sees appropriate. However, in Montana, under the Montana Supreme Court's landmark case In Re Rules of Professional Conduct and Insurer Imposed Billing Rules and Procedure (2000), the right is more properly described as a right to pay for counsel to defend the insured and whose obligation is to the insured and not the insurer. The duty to defend promised in the policies generally ends when "our limit of liability for this coverage has been exhausted by payment of judgments or settlements." Directors and Officers coverage varies the way it promises defense. Some policies have an express duty to defend while others provide for reimbursement of defense costs. Some that provide for reimbursement may allow the insurer to involve itself directly in the defense at its discretion. The basic difference is in the insurer's ability to dictate the defense. As part of the obligation to indemnify, the D & O policy promises to reimburse the insured if the insured opts to defend himself. Generally, the duty-to-defend policies give the insurer complete control over the defense of any claim. Again, in Montana, that would be an overstatement, since In Re Rules of Professional Conduct places significant restrictions on the insurer's right to control the defense or interfere with the decisions of the lawyer the insurer has selected to represent the insured. Under the policies, if the insured settles the claim, absent breach by the insurer, he does so on his own money, and cannot seek reimbursement. Moreover, by doing so, he would breach his cooperation clause with the insurer. Nevertheless, it is generally agreed that the insured can negotiate settlement of his liability above the policy limits.

Birth of the Insured's Right to Settle and Assign in Montana

The seminal case in Montana on the insured's right to settle in the face of the insurer's refusal to defend is the Montana Supreme Court's decision in the 1923 case of Independent Milk & Cream Co. v. Aetna Life Ins. Co. Aetna Life promised to indemnify and defend the insured for liability for personal injury suffered by persons other than the insured's employees arising out of use of a certain truck. The policy also provided that "the assured shall not voluntarily assume any liability or interfere in any negotiation for settlement or in any legal proceeding, or incur any expense, or settle any claim, except at its own cost, without the written consent of the company previously given." Also, "clause J" of the policy required that no action could lie against the insurer to recover any loss or expense unless it was actually paid by the assured "after actual trial of the issue."

The insured was sued for $30,000 for serious injury caused on John Ouimet arising from use of the insured truck. However, Aetna Life refused defense believing that Ouimet was an employee of its insured which belief was denied in the answer filed by the insured. The undefended, the insured settled the suit for $3,000 on advice of counsel and paid the settlement. The insured then sued Aetna Life for reimbursement, and the jury in that trial determined that Ouimet was not an employee. Aetna Life appealed that verdict and raised clause J on appeal contending that it was only responsible if the insured suffered a jury verdict as opposed to a settlement. The Supreme Court upheld the trial court's denial of Aetna Life's motions for a nonsuit and for directed verdict, and also deferred to the jury in its determination that Ouimet was not an employee.

Important to the jurisprudence of insureds' settlements is the courts' pronouncement in Independent Milk & Cream that the insurer's denial of liability and refusal to defend constituted a breach of the policy which "released the insured from its agreement not to settle the claim without the written consent of insurer and..."
waived clause J of the contract which had made actual trial of the claim a condition precedent to a recovery.13 To this day, Independent Milk & Cream is still good law in Montana, and its influence can be seen in every duty to defend case.

Nature of the Duty to Defend

The duty to defend is different from the duty to indemnify, independent from the duty to indemnify, and broader than that duty created in the same insurance contract.14 The duty to defend arises when a complaint against an insured alleges facts, which if proven, would result in coverage,15 or when the “insured sets forth facts which represent a risk covered by the terms of an insurance policy.”16 The duty “arises when the insurer, through reference to pleadings, discovery, or final issues declared ready for trial, has received notice of facts representing a risk covered by the terms of the policy.”17

The decision whether the duty is triggered is usually made by the insurer when it reviews the complaint that starts the action.18 The insurer, in comparing the allegations of the complaint to the policy coverage language, must “construe the allegations in the complaint, resolving all doubts about the meaning of the allegations in favor of finding the obligation to defend was ‘triggered’”19 “The fundamental protective purpose of an insurance policy and the obligation of the insurer to provide a defense require that coverage exclusions be narrowly construed.”20 Any doubt about whether coverage exists must be resolved in the insured’s favor.21 The insurer has the burden of proving that the exclusion applies.22 Moreover, the Montana Federal Court in Grindheim (1995) quoted with approval a New York court’s assertion that “a policy protects against poorly or incompletely pleaded cases as well as those artfully drafted... If, liberally construed, the claim is within the embrace of the policy, the insurer must come forward to defend its insured no matter how groundless, false, or baseless the suit may be.”23

The insurer must construe the facts from the insured’s perspective,24 that being the perspective of a consumer of average intelligence.25 “Unless there exists an unequivocal demonstration that the claim against an insured does not fall within the insurance policy’s coverage, the insurer has a duty to defend.”26 Accordingly, if there is a factual dispute about coverage, it must be resolved in favor of coverage for the insured.27

If the insurer chooses to look at facts beyond the complaint, it does so at its own risk.28 When the insurer receives a complaint and/or answer alleging facts within coverage it has a duty to defend regardless of whether its review can resolve the fact issues against coverage. The insurer cannot make disputed factual determinations to deny coverage. As the court said in Staples (2004), “[T]hat is not a question for the insurer to answer unilaterally upon receipt of only the complaint and/or answer. That question is reserved for the court or the jury.”29 Consequently, if the complaint alleges facts that would “expose the insured to liability covered by the policy, then the insurer must defend the insured, even if the subsequent ultimate resolution of disputed facts establishes that the event or risk is not covered by the policy.”30 Therefore, if the question of coverage is ambiguous, the carrier may be found to have breached the duty to defend even though the court ultimately finds there was no coverage.31 Where coverage facts are disputed, the insurer simply “cannot escape liability by declaring in advance of trial that the claim for damages is not one covered by the policy.”32

If, on the other hand, the allegations of the complaint demonstrate that no coverage exists, the insurer has no duty to defend and does not need to do any further investigation.33 However, the obligation to defend requires the insurer to not narrowly construe its coverage provisions and to interpret them from the perspective of its insured.34

If the complaint alleges facts outside insurance coverage but also facts inside the coverage, the insurer must defend.35 If the insurer refuses tender of defense in such a case, it will be estopped from ultimately denying indemnity on the claims outside coverage.36 Consequently, such an estoppel rule can actually create coverage where none exists.37 To avoid such estoppel and creation of coverage where none would have existed, the insurer can accept tender of defense under reservation of rights and file a declaratory action for an order that no coverage exists.38 The downside of doing so for the insurer is that it will bear the costs of defense in the period between tender and the court’s ultimate declaration that there is no coverage. However, the insurer is in the best position to bear that cost.39

Insurer’s Breach of the Duty to Defend.

Hence, the Montana Supreme Court in Staples (2004) warned that, if the pleadings allege claims within coverage, but the insurer believes it has a legitimate reason to refuse defense, it should tender defense under reservation of rights, and file a declaratory action.40 As Judge Erickson said of the Supreme Court’s statement:41

I remain amazed at the number of cases that have come before this court and the state courts in Montana over the years where presumably sophisticated insurance companies have ignored this maxim of insurance law at their peril. To save the relatively minor costs of tendering a defense
The Insured’s Right to Settle by Confessing Judgment

The insured who has been denied a defense has the right to settle the claim and enter an agreement under which he assigns to the claimant his rights against his own insurer and negotiates in return a covenant not to execute on the insured’s assets. The insured who is left on his own doesn’t have to defend himself to continue coverage, but can admit liability as long as he doesn’t do so in fraud or collusion. “[A]n insured who is abandoned by his liability insurer is free to make the best settlement possible with the third party claimant, including a stipulated judgment with a covenant not to execute. Provided that such settlement is free from fraud and collusion, the insurer will be bound thereby.” The insured can settle without litigating the coverage dispute with the insurer and without prejudicing the insured’s rights to litigate coverage. The insured can agree to default, and the judgment creditor can use the estoppel against the insurer even if that creditor did not take an assignment of the insured’s rights against the insurer. Consequently, the insurer cannot defend on the ground that the settlement is not an amount that it is “obligated to pay” under the basic insurance agreement. When the insurer wrongfully refuses to defend, it is simply bound by the judgment against the insured.

The judgment can be enforced in one of three ways: (1) by assignment of the insured’s rights; (2) if there is a statutory remedy, by bringing an action under the statute; or, (3) by a garnishment action. As can be seen in the Montana cases, enforcement by assigning the insured’s rights appears to be the favored remedy in Montana. In consideration for the confessed judgment and assignment of rights against the insurer, the insured negotiates for a covenant that the claimant will not execute on the insured’s assets. This means the judgment will ultimately be collected, if at all, from the insurer which denied a defense. “Absent fraud, when an insured enters a stipulation to judgment or offers a confession of judgment it is enforceable against the insurer.”

Insured’s Release from Obligations Under the Policy

By 1923, Independent Milk & Cream Co. had established that the insured is released from his obligations under the policy by the insurer’s breach of the contract for failure to defend. Hence, the insured is free from the duties under any “cooperation clause” that requires the insured to cooperate or assist the insurer in defending the claim. The breach also frees the insured from any clause prohibiting the insured from settling the case or any part of it.

Settlement agreements entered into by abandoned insureds generally do not express the specific basis for settlement. The insurer confronted with the settlement after wrongfully breaching the duty to defend will invariably argue first, that the insured’s potential liability did not justify the settlement, and second, that the insured is responsible for proving that it did. However, the insured need not prove the case against itself, and needs only show that the allegations of the complaint, alleging claims which have been compromised, are covered by the policy. Courts do not require the insured to deny liability to the point of settlement and then prove its liability in order to secure coverage of the settlement. So, the policyholder “does not have to prove de novo the existence of damage in the underlying action; i.e., its own liability.” To so require would place on the insured the burden of trying the underlying action in the coverage hearing. This would deprive the insured of the benefit it negotiated to
avoid defending itself when abandoned by its insurer. The insured does not need to establish actual liability to the plaintiff in the underlying case as long as “a potential liability known to the insured is shown to exist, culminating in settlement in an amount reasonable in view of the size of possible recovery and degree of probability of claimant’s success against the insured.”

That the insured does not have a burden to prove that liability justified the settlement is important, because it removes that issue from the declaratory action and, just as important, should remove that issue from discovery. The same insurer that denied the insured a defense will become very diligent about propounding discovery to the insured in the coverage action on the question of whether the insured made the right decision in settling and determining the amount of settlement. The court should protect the insured from such discovery which is irrelevant to the issues in the declaratory action.

Left untethered, the creative insurer will insist that all of the facts relevant in the underlying claim are now relevant for discovery and trial on the issue of “reasonableness” of the settlement. The court in the declaratory action should be alert to avoid such abuse. Moreover, the court and parties must keep in mind that the only evidence allowed on the coverage issue is that which was available to the insurer at the time of the settlement.

The only other relevant and admissible evidence is that evidence probative of issues of reasonableness and collusion.

Giving the Insurer Notice of Intention to Settle

Montana does not require the insured to notify the carrier that refused to defend that the insured intends settlement. However, it can be good practice to do so, because the insurer that has notice but does not participate has, absent fraud or collusion, likely waived any right to challenge the reasonableness of the settlement.

Presumption that the Settlement/Judgment Is Reasonable

In Independent Milk & Cream, the court noted, “That the compromise settlement effected by the respondent was fair and reasonable cannot be questioned ...” the implication being that the settlement needed to meet that standard. However, the court in Independent Milk & Cream Co. relied on then Section 8169, Rev. Codes 1921 (now MCA 28-11-316) to establish a presumption that the settlement is reasonable:

In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears: (4) The person indemnifying is bound on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses,

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if he chooses to do so; (5) If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter, suffered by him in good faith, is conclusive in his favor against the former.

The court determined that the burden of rebutting the presumption that the insured’s settlement was reasonable is on the insurer, and that is still good law in Montana today.

Since Independent Milk & Cream, the consent judgment in Montana is presumed reasonable unless procured by fraud or collusion. This is logical, because, under the policy, the insured has no duty to defend and can default. Consequently, if the claimant presents her case at an unopposed trial, the judgment would be enforceable. Justice Holmes, in the United States Supreme Court’s 1906 decision in St. Louis Dressed Beef & Provision Co. v. Maryland Casualty Co., reasoned, with regard to consent judgment by the insured, that the insurer’s promise is to pay judgments “after such precautions and with such safeguards as the defendant [insurer] may insist upon.” As Justice Holmes pointed out, the insurer which refuses defense “saw fit to insist upon none.”

Rebutting the statutory presumption of reasonableness would be most difficult. The insured is allowed to take into account the likelihood that the plaintiff would have recovered, the probable size of the recovery, the risks and costs of defending the litigation, and the uncertainties of the law and the facts. The courts are more concerned with whether the settlement was in good faith and fair than whether it reflects the exact measure of damages. An insured may settle for a figure higher than expected damages, because of the excessive financial burden of defense costs. This is especially relevant in cases involving claims against corporate insureds under CGL policies. Such cases are notorious for requiring defense costs that often exceed the indemnity liability limit and have been the impetus behind the use of defense within limits (DWL) liability policies which cap defense costs by including them in the liability limit. Arguably, the insured’s settlement soon after denial of defense saves defense costs which savings will ultimately inure to the benefit of the insurer which wrongfully denied coverage.

Excessiveness of the judgment cannot logically be judged by comparison of the amount for which the insurer could or would have settled. This is because the insurer is a “risk neutral” negotiator which has, by the law of large numbers and premium income, allowed it to promise to undertake defense and settlement of the claim without risk to itself. The insured is naturally “risk averse” which is why it transferred any risk of loss and risk of defense costs to the insurer in return for a payment of a premium. The insured knew that it could not handle the risk involved. Consequently, being denied coverage means the insured must deal with a risk of loss and defense costs that it knew would be ruinous to it in the first place.

For example, an automobile insured cannot take any risk that she will negligently cause an auto accident that results in death or serious injury to another. The gravity of the financial risk would be ruinous even if the probability is small. She is deemed “risk averse.” But the insurer will accept transfer of that risk, because its thousands or millions of auto insured’s paying premiums allow it to calculate the precise probability of accidents and the gravity of the damages. This is known as the “law of large numbers.” The insurer can then calculate its administrative costs and desired profit to set premiums that allow it to take transfer of the risk. It becomes “risk neutral” and is not negotiating to save its financial life. This is wholly different from the situation of the insured which is denied defense and indemnity. Deprived of promised defense and indemnity, the insured is negotiating to avoid financial catastrophe, has the poorest negotiating power, and must do whatever it takes to free itself from the loss that will cause it to financially capsize.

**Insured’s Right to Damages as a Result of the Insurer’s Breach**

Breach of the contractual duty to defend by the insurer entitles the insured to recover “such damages as were the natural and ordinary consequence of the breach.” If the insurer refuses to defend without justification, it becomes liable for defense costs and judgments. There is no duty to mitigate damages in breaches of contract. However, the contract rule simply blocks one from recovering damages which he could reasonably have mitigated. Nevertheless, most courts have refused to apply this mitigation rule in insurance coverage breaches. Consequently, the insured is not blocked from recovering damages that could have been mitigated by hiring a lawyer and paying for defense. Most courts reason that the carrier that refuses a defense assumes the risk that the insured will enter a default judgment.

The insurer must pay the underlying judgment in full regardless of whether it is in excess of the policy limits. Also, the insurer must pay interest and costs. The Federal District Court in Montana has held in Nielsen (2007) that interest is appropriate on the amount of the underlying judgment pursuant to 28 U.S.C. § 1961(a) (2000). The Federal Court noted in Nielsen that the Montana Supreme Court and the Ninth Circuit “also support this

Breaching insurers have been liable for defense costs in Montana since Independent Milk & Cream Co. v. Aetna Life Ins. Co. in 1923. Montana case law clearly provides that where the insurer refuses to defend a claim and does so unjustifiably, that insurer becomes liable for defense costs and judgments.” Where the insurer has wrongfully refused a defense, the court will award attorney fees under the Montana Uniform Declaratory Judgment Act, MCA § 27-8-313. The court established in Trustees of Indiana University v. Backman (2003), and Mountain West Farm Bureau Mut. Ins. Co. v. Breuer (2003), that insureds prevailing against insurers in UDJC cases could recover their attorney fees where “necessary or proper.” In Nielsen, after determining that attorney fees were recoverable, Judge Mollov ordered the claimant’s attorneys to file an affidavit “setting forth in detail any attorney fee’s claimed relating to this case” and specifically added, “Such affidavit shall indicate any contingent fees paid or to be paid in the underlying case.” Recently, in the State District Court case of Newman v. Scottsdale Ins. Co. and National Union Fire Ins. Co., Judge Christopher awarded the judgment creditor which successfully pressed a claim from an insured assigning its rights against its insurer the full amount of the 1/3 contingent fee entered into in the underlying case. This is logical, because the confessed judgment has no value to the claimant until her attorneys enforce it in the declaratory action for coverage.

Judgment in Excess of Policy Limits

Montana clearly allows recovery in excess of policy limits as can be seen in Nielsen. There, the court said, “… insurers who breach their duty are liable for the full amount of damages, including those in excess of the insurance policy limits.” In Nielsen, the court pointed out that breach of the indemnitor statute, MCA § 28-11-316 (2005) makes the breaching indemnitor liable for the judgment rendered. Schermers, in their treatise, Automobile Liability Insurance, report that, “Florida, Illinois, Kentucky, North Carolina, South Carolina, Washington and Wisconsin decisions have held or indicated that a wrongful refusal to defend could create insurer liability for the entire excess judgment even though an offer to settle within policy limits was not in the picture.”

Although not the rule in Montana, other courts hold that, absent an earlier demand for policy limits, the amount that can be recovered from the insurer as a result of a consent judgment cannot exceed the policy limits. It is argued that, “neither the insured nor the plaintiff has any right under the policy itself to payment of such amounts by the insurer.” Moreover, the insurer’s policy limits are not increased where the insurer’s only failure is refusal to defend. As in other situations, the insurer must have neglected a within-policy-limits demand to be responsible for an excess judgment.

Nevertheless, the Montana Federal District Court, in Nielsen, established that enforcement of a consent judgment does not require that there was any settlement demand within limits of the insurer’s policy with the insurer. The court in Nielsen noted that the Montana Supreme Court in the Lee decision, “… did not conduct a check to see if a settlement offer was made.” While this argument has been raised by others, it is rejected in Montana.

Montana’s rule allowing recovery in excess of the policy limits makes sense, because the insurer which defends and turns down an offer within limits will be liable for an excess judgment. Protecting insurers which refuse to defend from excess liability would be an incentive to insurers to refuse to defend as a way to avoid excess liability on big damage cases.

Collusion or Fraud

In Nielsen, the insurer sought to avoid the $5 million consent judgment by arguing that it was “… improper due to collusion among the attorneys. The court rejected the defense saying, “The proper time to attack the alleged improper relationships among the parties was during the underlying lawsuit. Moreover, as Judge Erickson found, Montana case law does not impose a duty upon courts to review the nature of the underlying judgment where the breaching insurance company failed to defend its client.” The court in Nielsen noted that:

In Lee v. USAA Cas. Ins. Co., the Montana Supreme Court awarded the amount of the confessed judgment, plus interest, plus costs to the plaintiff where the insurance company was in breach of its duty to defend. ** The Lee court did not conduct a review of the propriety of the underlying judgment that it imposed upon the defendant. ** The bottom line is when TIG neglected to assume its duty it assumed a risk. It is too late to cry foul now.

The court concluded in Nielsen.

The duty to defend is broadly applied for compelling public policy reasons. Insurance companies with legitimate questions can tender a defense with a reservation of rights. When insurance companies fail to comply with the law and the
terms of their policies, the courts are not, and have not been, required to go back and check to ensure the company was treated well when it refused to honor its agreement with its client. TIG’s defenses fail. The underlying judgment constitutes part of the damage recoverable here.

With regard to fraud, the insurer may claim that the insured’s confession of judgment is in direct conflict with the insured’s prior statements denying any liability. This was the situation presented in Staples where the insured had denied in his original answer that the subject horse was on his property or in his care but later confessed judgment in favor of the party injured by the horse. There the court said, “He did nothing more than concede that, given the disputed facts, there was a risk that a jury could find him at fault, even if he continued to deny liability.”

A careful practitioner would be well advised to insert a recital along that line in the confessed judgment to head off claims of fraud, collusion, or a defense attempt to rebut the statutory presumption of reasonableness.

Exchanging the Assignment for a Covenant Not to Sue

Generally, as part of the agreement to enter an undefended judgment, counsel will agree not to execute against the assets of the insured who confesses the judgment with the expectation that the creditor will only look to the insurance company for satisfaction of the judgment. In return, the insured assigns whatever rights he has against the insurer by reason of the refusal to defend. While some courts have held such an arrangement to constitute a release, the insured who is left on his own to defend can admit liability as long as he doesn’t do so in fraud or collusion. The insurer’s promise to pay is not destroyed by the insurer’s agreement with the claimant not to execute on the insured’s assets.

Clearly, in Montana, the insured can negotiate such a covenant. In Montana, the consent judgment is presumed to evidence the insured’s liability on the underlying claim, and the burden is on the insurer to show that it is unreasonable, collusive or fraudulent. The insured can even confess judgment on a groundless suit in the face of threat of expensive prolonged litigation.

What Happens if the Settlement Amount is Found Unreasonable?

If the insurer were to meet the burden of proving that the settlement is not reasonable, what should happen? Montana decisions do not appear to provide an answer. Logically the possibilities are: (1) the court could impose a type of remittitur where the insured could agree to an amount that the court found reasonable or have the settlement rescinded and the case reinstated for trial; or (2) the court could simply rescind the settlement and reinstate the matter for trial; or (3) the court could exonerate the insurer. Exonerating the insurer would make no logical sense and be unjust, assuming there has already been a determination that the original refusal to defend was wrongful. It would likely cause insurers an irresistible urge to put endless effort into attempting to show that any settlement was unreasonable. It has been argued that, if the plaintiff lost his/ her entire claim when a court found the settlement unreasonable, plaintiffs would moderate their settlements accordingly. While such a draconian rule may in fact have that effect, it lacks any rationale.

The Minnesota Supreme Court, in Alton M. Johnson Co. v. M.A.I. Co. (1990), reasoned that the fairest option in the face of an unenforceable stipulated settlement was to rescind and reinstate the matter for trial. The benefit of imposing a type of remittitur as an alternative to trial is pure convenience for the parties and the court.

Facts in the Montana Cases

The facts of Independent Milk & Cream Co. v. Aetna Life Ins. Co. (1923) were related earlier in the article. Because the Montana Supreme Court’s Staples (2004) and Lee (2004) cases, and the Federal District Court’s Grindheim (1995) and Nielsen (2006) cases, are so important in the development of the remedies for failure to defend, it is good here to recount their facts.


In Grindheim, the plaintiffs claimed injury from disposal of human and animal waste by their neighboring Deerfield Hutterite Colony. Safeco refused tender of defense of the suit under its farm and ranch liability policy on the basis of its pollution exclusion and on the ground that there was no covered “occurrence” or accident, the pollution being deliberate. Faced with the potential costs of defense and liability in the case, the Deerfield Colony settled the case by confessing judgment for $500,000, assigning the Colony’s rights as insured against Safeco in satisfaction of the judgment, and accepting a covenant not to sue from Grindheims.

Grindheim then sued Safeco in federal court to enforce the consent judgment as assignees of the Colony’s rights for breach of the insurance contract and breach of the duty of good faith and fair dealing. Grindheim brought a second action in federal district court seeking attorney fees, costs, costs of remediation, and costs of preventing future damage which action was consolidated with the action to enforce the judgment.
Judge Hatfield found that Safeco owed a duty to defend, that it breached that duty by narrowly interpreting its coverage agreement, and that the Deerfield Colony was entitled to all the damages it sustained as a result of Safeco’s breach. This case is the source of much of the law cited throughout this article.


In Staples, Farmers Union Mutual Insurance Company (FUMIC) insured Corcoran as the named insured under a ranch liability policy and also covered as an additional insured any non-business person legally responsible for Corcoran’s animals. Huntsingers suffered serious injuries when their car struck a horse named Frenchy on a road near Havre. Ownership of the horse was unclear and in dispute, and it was thought that the horse came from Staples’s property when the accident occurred.

Huntsingers sued Staples who filed a third party complaint and a later amended complaint each alleging that Corcoran was a part owner of the horse, which would mean FUMIC’s policy would cover Corcoran as the named insured and Staples as an additional insured. However, FUMIC unilaterally determined for itself that Corcoran was not the owner of the horse and refused defense of Staples as an additional insured.

Left without coverage, Staples confessed judgment in favor of Huntsingers acknowledging evidence from which a jury could find him liable for Huntsingers’ damages. He then assigned his rights to Huntsingers in return for a covenant not to execute. FUMIC filed a declaratory action seeking a declaration that it had no duty to defend or indemnify Staples and that the judgment he confessed was void. On cross motions for summary judgment, the trial court determined that, under the allegations of the complaint, FUMIC had a duty to defend, but that, on the facts developed, Corcoran did not own the horse and could not give permission for the horse to be on Staples’s property, so that Staples was not an additional insured.

The Montana Supreme Court reversed the District Court’s conclusion that Staples was not an additional insured and upheld that court’s conclusion that FUMIC owed Staples a duty to defend on the pleadings. 122 The Supreme Court held that FUMIC, having unjustifiably refused to defend, was estopped from denying coverage so that Staples was entitled to summary judgment. Of great importance is the precedent established that, where there is a fact dispute on coverage, the insurer cannot make itself the adjudicator. It must defend on the allegations of the complaint and let the court or jury adjudicate the coverage fact dispute. 123

C. Lee v. USAA Cas. Ins. Co. 124

In Lee v. USAA, Lee individually owned a vehicle insured with State Farm. She and Hoss bought a 1988 Acura together so that they co-owned two vehicles. Hoss promised that if Lee would drop her insurance with State Farm, he would add her as a named insured on his USAA policy with $100,000 limits. Hoss failed to insure her, and she was subsequently injured as a passenger in a taxi cab. Lee recovered the $10,000 BI limit from the negligent tortfeasor.

Lee sought UIM benefits in a suit against USAA which she lost. The Montana Supreme Court upheld the verdict in favor of USAA on the ground that Lee never was a named insured. 125 Lee then sued Hoss under his BI coverage for breach of his verbal promise to Lee, asserting that she had been damaged by detrimentally relying on Hoss’s promise. Hoss tendered defense to USAA which refused and denied any duty to defend or indemnify. Hoss then confessed judgment for $284,500.

Lee and Hoss sued USAA for
indemnification under the standard basic coverage agreement which contained the broad promise that, “We [USAA] will pay damages for BI [bodily injury], ... for which any covered person becomes legally responsible because of an auto accident.” The coverage provision contained ten exclusions none of which excluded liability arising out of breach of contract.

The trial court found for Lee and Hoss awarding $100,000 to Lee with interest and costs and $184,500 to Hoss with interest and costs. The trial court also rejected USAA’s defenses of res judicata and collateral estoppel.

The Montana Supreme Court upheld the lower court and ruled that, because there was no BI coverage exclusion for breach of contract, under the broad language of the basic coverage agreement, USAA owed a duty to defend and indemnify and had to pay the excess judgment of $184,500 over the $100,000 limit. The court also held that there was no collateral estoppel because the prior issue, whether Lee was a named insured for UIM coverage, was different from the issue of whether USAA had a duty to defend and indemnity Hoss under the BI coverage.

D. Nielsen v. TIG Ins. Co.125

In Nielsen, the employer, Confluence Expeditions, L.C., was sued for negligent failure to warn others of the poor driving record of its employee, David Hanna. Hanna caused serious injuries to plaintiffs in an auto accident. Confluence was also sued for breaching a duty to prohibit Hanna from transporting plaintiffs. The suit against Hanna and Confluence was defended by the auto insurer that covered the auto, but Confluence also tendered it to its CGL carrier, TIG Insurance Company for defense and indemnity. TIG refused coverage on the basis of an exclusion for damage arising out of “ownership, maintenance, use or entrustment to others” of an auto owned by Confluence.127

After sending three letters tendering defense, Confluence advised TIG in a letter that, in order to protect itself, it might agree to an entry of judgment in return for a covenant not to execute and a possible assignment of its rights. Plaintiffs and Confluence settled the case and, by agreement, set a hearing at which the damages were determined. Confluence agreed in advance not to contest the amount established at the hearing “unless the proof offered or damages requested is collusive, fraudulent, or improper.” The court held a two hour hearing and after hearing concluded that “Plaintiffs were entitled to in excess of $8 million in damages.”

Judge Molloy held that TIG had a duty to defend in the circumstances. He rejected as “dishonest” TIG’s argument that Confluence breached the cooperation clause, because of the correspondence that revealed the company repeatedly tendered the case for defense, forwarded pleadings, and kept TIG informed of Confluence’s necessity to settle, noting that under Staples, “all that is required is notice of the pleadings.”128

Conclusion

Montana courts, like others across the nation, rigorously enforce an insurer’s duty to defend. They resolve coverage determinations by liberally construing coverage in favor of the insured and narrowly construing exclusions. They warn that the insurer which denies coverage does so at its own peril.

Nevertheless, Montana case law is legion with decisions holding that, where the facts of the complaint do not implicate coverage, the insurer need not do further investigation and has no duty to defend or indemnify. On the other hand, if the insurer wrongfully refuses defense, even if in good faith, it has breached the policy contract and freed the insured to fend for himself. The insured has no duty to defend himself in the first place, and may settle the case and assign any rights he has against the insurer to the claimant in return for the claimant’s covenant not to execute. Such a settlement is presumed reasonable and not collusive. Subsequent challenges of the settlement by the insurer with the duty to defend, should focus more on simply whether the settlement was collusive or fraudulent.

The risk averse insured who has been denied defense and indemnity by its risk neutral insurer is in a perilous and often financially ruinous position with no bargaining power save for trading away whatever rights he has against the insurer that has wrongfully denied defense. If the insured can negotiate a settlement figure that is not collusive or fraudulent and is based on considerations of such things as risk of liability and the costs of attempting to defend, the insurer will be liable for the confessed judgment. This is so even if the insured negotiated a covenant not to execute on the insured’s property in return for the assignment. It is also true regardless of whether the insurer acted in good faith in denying defense in the first place.

The insurer will be estopped from raising defenses it could have raised in the underlying action and will be estopped from raising other coverage defenses. Ultimately, in Montana, the insurer will be liable for the underlying or confessed judgment, the insured’s attorney fees and costs expended in defending the underlying claims, interest on the judgment and attorney fees in the coverage action that are recoverable under the Uniform Declaratory Judgment Act.

As can be seen, the insurer that denies coverage when it depends on disputed facts does so at its own peril and can suffer dire consequences. The remedy for the insurer is to provide
defense under reservation of rights where coverage is disputed and file a declaratory judgment action to ascertain that there is no coverage. The insurer has little to lose in taking this safe route. There are far more cases in Montana where the courts have held that allegations of a complaint fall within a clear exclusion to coverage and therefore do not invoke any duty to defend or indemnify, thus relieving the insurer of any further duty to investigate, defend or indemnify.

When the breach of duty to defend issue is tried, the only questions are: (1) whether there was coverage on the facts and allegations known by the insurer at the time it denied coverage, (2) whether the settlement entered into by the insured was in good faith, and (3) whether it was collusive. The settlement is presumed fair, and the insured need not prove its liability in the underlying case. Moreover, the court should not measure reasonableness of what the risk adverse insured was forced to do by what a risk neutral insurer would have negotiated.

For the most part, there is nothing unusual or unfair to insurers in Montana’s remedies for the insured wrongfully denied defense. Courts across the country have traditionally protected insureds from the risk that their insurer will wrongfully deny them defense. There is much logic and justice in how Montana courts have treated wrongful denial of defense ever since Independent Milk & Cream Co. v. Aetna Life Ins. Co. in 1923.

ENDNOTES
1. See, for example, Insurance Services Office, Inc., property policy form, 1999, E0 00 03 10 00 (1999), pg. 16, commercial general liability policy form CG 00 01 12 07 (2006) pg. 1; and auto policy form PP 00 01 01 05, 2003, pg. 2.
2. Id.
3. 2000 MT 110.
4. See, for example, auto policy form PP 00 01 01 05, 2003, pg. 2.

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