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Florida Supreme Court Holds That Bad Faith Liability Requires Actual Damages or Exposure to an Excess Judgment Under Contracts For Liability Insurance

Answering questions certified to it by the U.S. Court of Appeals for the Eleventh Circuit, the Florida Supreme Court held in *Perera v. United States Fidelity & Guaranty Company*, No. SC08-1968 (May 6, 2010), that a bad faith claim against a liability insurer requires a causal connection between the alleged bad faith and the insured's damages or exposure of the insured to liability in excess of limits of the insured's policies.

Perera arose out of a wrongful death suit against the insured, Estes Express Lines Corporation ("Estes"), from the death of Mrs. Perera's husband. Estes had three indemnity policies that could respond to Mrs. Perera's claim: a primary commercial general liability policy with a $1 million limit, an excess worker's compensation employer's liability policy from United States Fidelity and Guaranty Company ("USF&G") ($1 million limit) and an umbrella excess liability policy issued by Chubb Group of Insurance Companies ("Chubb") ($25 million limit).

Unlike Estes' primary and umbrella insurers, USF&G did not acknowledge coverage. Despite its disclaimer, USF&G attended a mediation along with Estes and the other insurers. Perera demanded $12 million to settle her claims. USF&G refused to tender its policy limits and was asked to leave the mediation, which concluded without settlement when the remaining parties were unable to meet Perera's final $8 million demand.

Following the mediation, Chubb continued the negotiations and, soon thereafter, the parties agreed to settle the claim for $10 million. Of that amount, Estes and its primary and umbrella insurers contributed $5 million and agreed that the remaining $5 million of the settlement was to be recovered in a lawsuit against USF&G, which Estes assigned to Mrs. Perera. The trial court entered judgment against Estes after determining the settlement was reasonable and in good faith.

Perera then sued USF&G for breach of contract and bad faith to recover the balance of the settlement. She sought the $1 million policy limit as damages for the breach of contract claim, and the remaining $4 million of the settlement balance for the bad faith claim. Perera obtained summary judgment on the contract claim. The court held, however, that there was no cause of action for bad faith. The court reasoned that the $4 million settlement balance was not a judgment in excess of the insured's policy limits because Estes had $21 million in remaining insurance coverage available under the Chubb policy at the time of settlement. Perera appealed to the Eleventh Circuit, which remanded the case for determination of the threshold question of whether USF&G had acted in bad faith. On remand, a jury found that USF&G acted in bad faith.

The case went up to the Eleventh Circuit again, which agreed that the insured was never subject to potential exposure above policy limits but questioned whether under Florida law an excess judgment was necessary to maintain a bad faith claim. The court, therefore, certified the issue to the Florida Supreme Court.

The Florida court framed the question as whether a cause of action for third-party bad faith can be maintained against an indemnity insurer when the insurer's actions did not cause injury to the insured or when the insurer's actions did not lead to exposure in excess of the insured's policy limits.

The court noted first that even under policies that do not require a defense, insurers still owe a duty of good faith to the insured when evaluating settlement demands. Next, the court examined the four circumstances under which Florida law permits an insured or third-party claimant to assert a common-law third-party bad faith claim for damages allegedly caused by the insurer's bad faith.

First, bad faith may be alleged against an insurer when the insurer has breached its duty of good faith, resulting in a judgment against the insured in excess of the policy limits. Second, a claim for bad faith can be maintained when the insurer and a third-party claimant agree to try the bad faith issues before an excess judgment is entered and stipulate that absent a finding of bad faith, the claimant will settle for policy limits. Such an agreement, known as a *Cunningham* agreement, is the functional equivalent of an excess judgment. Third, a bad faith claim is permissible where the insured and the third-party claimant enter into a *Coblentz* agreement, which, in the context of bad faith, is essentially an agreement consenting to a judgment against an insured in excess of the policy limits. Lastly, an excess carrier may, by equitable subrogation, bring a bad faith claim against a primary insurer when the excess insurer was exposed to more liability under its policy than it would have paid had the primary insurer acted in good faith.

After discussing these four scenarios, the court stated that while an excess judgment is not a prerequisite to a bad faith action, a causal connection between the claimed damages and the alleged bad faith is required. To illustrate this principle, the court discussed *North American Van Lines v. Lexington Insurance Co.*, 678 So. 2d 1325 (Fla. Dist. Ct. App. 1996). In *North American*, the injured third party made a settlement demand exceeding the insured's primary policy, but within its excess policy. While the primary carrier agreed to tender its limits toward settlement, the excess carrier refused. The insured thus paid the balance of the settlement demand exceeding the primary policy and subsequently brought suit against its insurer for bad faith and breach of contract. While the *North American* trial court dismissed the case, holding that an excess judgment was required to maintain the action, the court of appeals reversed. The court of appeals noted that the insured almost certainly faced a judgment in excess of its policy limits if it did not meet the settlement demand. The court reasoned that had the excess insurer not breached the contract, it would have been liable for the settlement amount in excess of the primary policy. Accordingly, there was a causal connection between the excess carrier's bad faith and the insured's damages.

The Florida Supreme Court then determined that the *Perera* case was dissimilar to those recognized scenarios in which a bad faith claim can be maintained against an insurer. Perera argued that the $4 million settlement balance was an excess judgment because it exceeded USF&G's policy limit. The court rejected this argument, relying on settled Florida law that defines an excess judgment as the difference between all available insurance coverage and the amount of the verdict recovered by the injured party. Even absent USF&G's coverage, the insured was never faced with a situation where it had to tender its own assets to satisfy the settlement demand but, rather, was at all times protected by its other insurance policies.

The Florida court further explained that this case was distinguishable from *North American* because there was no claim here that an excess insurer acted in bad faith. Perera's settlement demands were always well below the limits of the combined insurance policies, so that unlike *North American*, there was little, if any, risk that the insured would suffer an excess judgment if the case failed to settle. Accordingly, the court held that the $4 million balance of Perera's settlement was not the result of USF&G's bad faith.

Perera argued that USF&G's bad faith led to the $4 million settlement balance because USF&G's bad faith denial of coverage resulted in a coverage gap, which Chubb ultimately agreed to fill after Estes agreed to reduce the amount of Chubb's overall contribution. Under the terms of the Chubb policy, Chubb was not obligated to contribute to settlement until the underlying USF&G policy was exhausted. Chubb, however, agreed to waive the requirement that USF&G's policy be exhausted and contributed a fraction of its policy limit toward settlement in exchange for a release of any further claims against Chubb. Perera claimed that the reduction in Chubb's coverage was the direct result of USF&G's failure to offer its policy limits. The court rejected this argument, noting that Chubb had at all times been willing to contribute to settlement regardless of whether USF&G's policy was first exhausted. Thus, USF&G's conduct did not cause Perera's claimed damages because regardless of whether USF&G should have paid its limit promptly, there was no causal connection to the claimed damages.

Implications

The Florida Supreme Court's decision clarifies Florida bad faith law. While an excess judgment is not itself a required element of a bad faith claim, the insured must suffer actual damages causally connected to the bad faith or be exposed to liability in excess of all available insurance (including excess coverage) in order to maintain a bad faith claim.