

Southern District of New York Permits Excess Insurer's Bad Faith Claim To Proceed To Trial

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Under New York law, a primary insurer owes a duty of good faith to its excess insurer, specifically when deciding whether to settle a claim.

See *Pavia v. State Farm Mut. Auto. Ins. Co.*, 82 N.Y.2d 445, 452 (1993); *St. Paul Fire & Marine Ins. Co. v. U.S. Fid. & Guar. Co.*, 43 N.Y.2d 977, 978 (1978). Although New York courts don't often entertain bad faith claims against insurers, in *Scottsdale Insurance Co. v. Indian Harbor Insurance Co.*, 12 Civ. 2632 (PAE), the court recently held that a primary insurer's initial refusal to tender its policy limit towards settlement of an underlying personal injury action, which ultimately gave rise to an excess settlement, was substantial evidence of bad faith. The case provides guidance to insurers regarding how a court may view a bad faith claim in the context of a failure to settle within primary limits.

In *Scottsdale*, *Scottsdale Insurance Co.*, the excess insurer to *Cole Partners, Inc.*, alleged that *Indian Harbor Insurance Co.*, *Cole's* primary insurer, acted in bad faith and with gross disregard to *Scottsdale's* interests by failing to settle an underlying lawsuit against *Cole* within *Indian Harbor's* \$1 million primary policy limit. The underlying lawsuit arose from an 18-foot fall at a Queens construction project, resulting in severe injuries to plaintiff. *Cole* had a \$1 million primary insurance policy with *Indian Harbor* and a \$10 million excess insurance policy with *Scottsdale*. *Indian Harbor* assumed the defense of *Cole* and appointed defense counsel on its behalf.

Under New York law, to prevail on a bad faith failure to settle claim against a primary insurer, an excess insurer must establish that a) the primary insurer exhibited "gross disregard" for the interests of the excess insurer; and b) this gross disregard caused the loss of an actual opportunity to settle the case within primary policy limits.

In the decision, the court found "substantial evidence" of *Indian Harbor's* gross disregard for *Scottsdale's* interests. The court undertook a careful inspection of *Indian Harbor's* claims handling and based its comments upon the following factors: (1) liability against the insured was certain; (2) *Indian Harbor's* failure to consider the possibility that the plaintiff would need back surgery for his injuries, thus increasing the potential damages; and (3) *Indian Harbor's* failure to engage in meaningful settlement negotiations in offering substantially less than the recommended settlement value received from defense counsel. The court recognized that "a primary insurer's unrealistic settlement posture that exposes an excess carrier to risk is potentially significant evidence of bad faith" and ultimately noted that "*Indian Harbor's* failure to make a plausible offer in the face of palpable risk to the excess carrier evinced bad faith."

Notwithstanding the court's recognition that the claims handling "[was] incompetent and reckless, and that *Indian Harbor's* failure to even attempt settlement negotiations evinced gross disregard for the possibility that *Scottsdale* would be exposed to substantial liability," the court ultimately held that there was an issue of fact as to whether "*Indian Harbor's* bad faith caused it to lose the opportunity to settle *Dickson's* case for an amount within the primary policy." The court was faced with conflicting evidence

concerning whether plaintiff would settle the claim for the \$1 million primary limit. Accordingly, the court denied both insurers' summary judgment motions and required the matter to proceed to trial. The court's decision provides insurers with substantial insight into the manner in which a court will review their claims handling and emphasizes the need for prompt and proactive claims handling.