

# WHEN TO DEFEND

Can Insurance Company Ever Deny Coverage Under Current Missouri Case Law?

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I have devoted a good portion of my legal career to providing coverage advice to insurance companies. In fact, that advice almost always included a recommendation as to when coverage could safely be denied, when coverage was clearly available, and when a defense should be provided under a reservation of rights. Recent cases out of the Missouri Supreme Court and lower appellate courts have made it difficult, if not impossible, for an insurance company to know what to do. This article will discuss Missouri cases regarding the duty to defend and the pitfalls inherent in making the wrong decision.

The first step an insurance claims person must take in determining whether or not there is a duty to defend their insured is to compare the language of the insurance policy and the allegations contained within the four corners of the petition against the insured. If the complaint alleges facts that state a claim potentially within the policy's coverage, there is a duty to defend. *Moore v. Commercial Union Company*, 754 S.W.2d 16 (Mo.App.E.D. 1988). This is generally referred to as the four corners doctrine.

Missouri courts have made it clear, however, that you can't stop there. The insurer must look beyond the four corners of the petition and consider facts reasonable known to the insurer following an investigation. *Travelers Insurance Company v. Cole*, 631 S.W.2d 661 (Mo.App. E.D. 1982). This is often referred to as the modified four corners doctrine.

An interesting question arises in many states as to what to do when some of the allegations in the petition are covered and others are not. Missouri is fairly clear on this issue, finding that if any part of the petition against the insured is even arguably within the scope of the policy's coverage, the insurance carrier must defend the entire lawsuit. *Missouri Terrazzo Company v. Iowa National Mutual Insurance Company*, 740 F.2d 647 (8<sup>th</sup> Cir. 1984).

Often times, however, the question of coverage can fall into a gray area. Either the facts necessary to determine coverage under the policy are unclear, or the law interpreting coverage under your fact situation is murky or has not yet been addressed. Three options are available to the insurance company.

First, the insurance company can accept coverage without reservation. When that occurs, the insurance company is obligated to defend the matter and either settle the case for the benefit of its insured or pay any judgment rendered against their insured within the coverage limits of the

insurance policy. Second, they can deny coverage and refuse to provide a defense. Only in situations where the undisputed facts clearly establish that coverage is not available under the policy should this option be employed. The final option is to offer to defend the insured with a reservation of the insurance company's right to later deny coverage if it is determined that no coverage was provided under the policy. This decision to provide coverage under a reservation of rights reservation must include a formal letter by the insurance company to the insured offering to defend the insured without waiving its rights. The contents of such a reservation of rights letter are crucial in preserving the insurance company's rights. Failing to right such a letter prior to undertaking the insured's defense, or failing to include certain necessary elements within a reservation of rights letter will constitute a waiver of the insurance company's right to later deny coverage.

In Missouri, as in most states, you have the option of filing a declaratory judgment action to obtain a judicial determination of coverage. In a few states, like Illinois, you must file a declaratory judgment action contemporaneously with defending under a reservation of rights or you waive any coverage defense.

As a practical matter, it is difficult to get a Missouri court to hear a declaratory judgment action while the underlying civil case is on-going. There are practical difficulties. The underlying case against the insured was filed first. In jurisdictions that assign a docket number based on time of filing, it can be difficult to obtain a trial setting on a declaratory judgment action before the underlying case goes to trial. Prior to *State ex rel. Rimco v. Dowd*, 858 S.W.2d 307 (Mo. Ct. App. 1993) the usual procedure was to have the insurance company intervene in the underlying lawsuit and request a stay until the declaratory judgment action could be ruled on. The *Rimco* Court held that motions to intervene for such a purpose should generally not be allowed, particularly when the parties were proceeding under a Section 537.065 agreement.

There are also issues regarding Missouri case law that make it difficult to convince a trial judge to make findings of fact in a declaratory judgment action that will be binding on a jury in a subsequent civil trial. For instance, filing a declaratory judgment action in order to establish that the insured acted intentionally in injuring the plaintiff and is, therefore, barred from coverage under the "expected or intended injury" exclusion would preclude the parties from later contending that the injury occurred negligently or that the insured wasn't liable at all. In those circumstances, a trial judge in a declaratory judgment action will often dismiss the declaratory action or stay proceedings until the underlying case can establish the facts necessary to determine coverage.

It is axiomatic that the duty to defend is broader than the duty to indemnify. If an insurance company fails to defend its insured, and it is later determined that the duty existed, the insurer is responsible for all damages "flowing from the breach of contract." It is liable to its insured up to the policy limits, plus attorneys' fees, costs, and other expenses. *Landiu v. Century Indemnity Company*, 716 S.W.2d 568 (Mo.App. 1986).

Until fairly recently, the failure to defend alone did not appear to subject an insurance company to general damages beyond its policy limit. Failure to defend was considered a breach of contract claim and the general rule that punitive damages are not awarded for breach of contract unless

the breach is an independent and willful tort. *Ladeas v. Carter*, 845 S.W.2d 45 (Mo.App. 1965). Missouri had recognized a tort for “bad faith failure to settle” against an insurance company and has still specifically never recognized a generic bad faith tort. In the past, there had to be proof that the decision by the insurer not to settle was done in bad faith or an intentional disregard of its insured’s financial interest in the hope of escaping responsibility imposed upon it by its policy in order to award damages beyond the policy limits. *Zumalt v. Utilities Insurance Company*, 228 S.W.2d 750 (Mo. 1950).

Two recent cases out of the Missouri Supreme Court and one out of the Missouri Court of Appeals for the Western District have caused confusion over the scope of bad faith exposure for insurance companies. *Columbia Casualty Company v. HIAR Holding, LLC*, 411 S.W.3d 258 (Mo.banc. 2013); *Schmitz v. Great American Assur. Company*, 337 S.W.3d 700 (Mo.banc. 2011); *Advantage Buildings & Exteriors, Inc. v. Mid-Continent Casualties Co.*, 449 S.W.3d 16 (Mo.App.W.D. 2014).

*HIAR Holding* was a case where the insurance company refused to defend and it was later determined that coverage, in fact, existed under the policy. The Court held, consistent with prior rulings, that the insurance company was bound by the damages determined by the trial court in the underlying action. The Missouri Supreme Court *en banc*, however, made two more implicit findings in upholding the lower court’s judgment. First, the court found that factual determinations relevant to coverage that were made in the underlying cases were binding on the insurance company in the garnishment action. They did this when they determined that a prior finding that the insured acted negligently was binding on the insurance carrier in the subsequent garnishment action. Secondly, the Court upheld damages that were awarded in excess of the policy limits against the insurance company for “bad faith” even though no separate claim of bad faith was ever brought against the carrier and the insurance company apparently had no opportunity to specifically defend itself on that issue. The Court asserted that there were sufficient facts plead to indicate bad faith on the part of the insurer, but that the insurance company was merely “suffering the consequences of its breach of the duty to defend and failure to settle within the policy limits.” *Id.* (citing *Shobe v. Kelly*, 279 S.W.3d 203, 210 (Mo.Ct.App. 2009)).

In ruling shortly before *HIAR Holding*, the same Supreme Court *en banc* sanctioned a method for binding an insurance company to an amount of actual damages that could not be contested by the insurance company directly. In *Schmitz v. Great American Assur. Company*, *supra*, the Court held that once an insurance company failed to defend and the plaintiff obtained a court-entered judgment, the amount of that judgment was binding on the insurance company and could not later be contested in a garnishment proceeding. This is particularly troubling because such a judgment is usually issued by a judge following a non-contested bench trial. In other words, only the plaintiff puts on evidence of the amount of damages, which is never subject to cross-examination in that no representative of the insurance company is present at such a proceeding. The Court specifically justified this conclusion because an independent trial judge is supposed to act as a check on the reasonableness of the judgment that he or she enters. The Court did not discuss, however, the nature of such a proceeding and the fact that no evidence opposed to plaintiff’s damages amount is ever placed before the trial judge or finder of fact.

Both of these cases arose out of the context of a §537.065 agreement or at least a modified version of such an agreement. Missouri may be unique in having such a statute although other states come to a similar result through the operation of case law. §537.065 allows an insured who has been denied coverage the right to enter into an agreement with a plaintiff to allow judgment to be taken against him or her in exchange for a promise that such judgment will only be collectable against the insurance carrier who denied coverage. The statute seems to contemplate an actual denial of coverage and written agreement as to the amount of a confessed judgment that will be entered by a court. A problem arises for an insurance company under this procedure, however, because they cannot force an insured to accept the defense of a law suit under a reservation of rights. In fact, since *Butters v. City of Independence*, 513 S.W.2d 418 (Mo. 1974) the insured has had the right to force the insurance company to withdraw its reservation of rights or withdraw its defense counsel. If the insured chooses not to withdraw its reservation and admit to coverage it is treated thereafter as a denial freeing the insured to enter into a §537.065 agreement. This makes the attempt to defend under a reservation of rights a situation which is solely controlled by the insured.

The *HIAR* and *Schmidtz* cases provided a blue print for a “workaround” from the holding in *Gulf Insurance Company v. Noble Broadcast*, 936 S.W.2d 810 (Mo.banc. 1997) wherein the Court said that an agreed judgment amount contained in a §537.065 agreement could still be contested by the insurance company in a garnishment proceeding as to the “reasonableness” of the amount. Based on the writer’s experience, it appears that the plaintiff’s bar has unanimously adopted this workaround and is submitting all §537.065 agreements to a judicial determination of the damages amount. Amounts that are agreed to by the parties, pursuant to the statutory procedure contained in §537.065 are simply no longer happening.

An additional concern regarding the duty to defend has recently arisen following the Western District Court of Appeals’ decision in *Advantage Buildings & Exteriors, Inc. v. Mid-Continent Casualties Co.*, *supra*. In that case, the insured was defending under a reservation of rights and eventually filed a declaratory judgment action to establish that there was no coverage for their insured under the policy. Although the trial court eventually ruled that there was no coverage under the policy, they nonetheless entered judgment against the insurance carrier for an amount in excess of the policy limits. The Court held that the insurance company waived its policy defenses by sending out inadequate reservation of rights letters prior to undertaking the defense. The fact that the insurance company had been right all along, that there was no coverage under the policy, did not protect them.

The holding is particularly troubling when you review the two reservation of rights letters attached to the Court’s opinion, which were held to be “completely inadequate.” The letters were, in fact, very detailed describing plaintiff’s claims, the relevant portions of the insurance policy where coverage was in dispute, and offering to defend under a reservation of rights. In this case, the insured was also represented by personal counsel who was there to advise the insured on the coverage issues. This writer has written an article separately on this issue questioning whether a reservation of rights letter that would pass muster under *Advantage Buildings* could ever be written. The article also discusses whether it is wise to require such a detailed reservation of rights letter both as a practical matter and for policy reasons. The article may be viewed on line at [www.rssclaw.com](http://www.rssclaw.com).

Unfortunately, the conclusions that can be drawn for the insurance claims person regarding the decision to provide a defense to their insured in a civil law suit are not comforting. Denying coverage and failing to provide a defense subjects the insurance company to be bound by manipulated coverage evidence pursuant to the blueprints created by the Missouri Supreme Court under *Schmitz* and *HIAR*. Defending under a reservation of rights runs the risk of waiver of policy defenses by the insurance company if a reservation of rights letter is not sent in a timely manner or is insufficiently clear under *Advantage Buildings*. Even if the company agrees to defend the insured under a reservation of rights it is still possible for the insured to force the company into the uncomfortable position of withdrawing any objections to coverage or being treated as if they had outright abandoned their insured to the risks of litigation. Under either of those scenarios, the insurance company may be exposed to unlimited liability beyond their policy limits. By defending the case without reservation, the insurance company avoids excess exposure, but also may be paying for damages that they do not owe under their policy. There is simply no safe haven for an insurance company operating in Missouri under the current case law.

This writer is aware that attempts are being made to make statutory changes through the Missouri legislature to remedy the untenable situation that has developed. To date, no such legislation has been enacted as it is being vigorously opposed by the plaintiffs' bar in the state.