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Assignee of Bad-Faith Claim Can Proceed Against Insurer For Bad-Faith Failure to Settle

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The Colorado Supreme Court recently found that when a liability insurance company fails to fund a reasonable settlement within policy limits, the policyholder may settle the underlying lawsuit, assign its bad-faith claim to the injured person, who then can pursue bad-faith damages against the breaching insurer. The fact that the policyholder was released from liability when it settled the underlying claim does not preclude the assignee's bad faith cause of action. *Nunn v. Mid-Century Ins. Co.*, 2010 WL 4814696 (Colo. Nov. 22, 2010).

Background

Insurers who wrongfully refuse to settle a third-party claim for an amount within policy limits can be liable for judgments in excess of policy limits; the theory is that the insurer had the opportunity to settle the claim but refused to, and any judgment in excess of the policy limits was caused by the insurer's refusal to settle. A great many courts have held that the insured should not be personally responsible to pay for the judgment portion that exceeds policy limits where the insurer squandered the opportunity to settle the claim for an amount within those limits.

But what happens when the insured stipulates to a judgment in excess of policy limits, assigns its bad-faith failure-to-settle claim to the third party, and the third party covenants not to execute the judgment against the insured? In such a case, the insured would never be personally liable for the judgment portion in excess of policy limits—but should the insurer still be liable?

This was the question at hand in *Nunn*. The facts in the case show that the insured, Bryan James, was driving a car carrying five passengers, including Nicole Nunn, when James lost control of the car. As a result, Nunn was permanently paralyzed from the waist down. Before a suit was filed, Nunn apparently made an offer to Mid-Century to settle her claim for an amount within policy limits; she claims it refused (Mid-Century disputed this). She sued, and prior to trial she and James entered into a stipulated judgment of $4,000,000. James then assigned his bad-faith claims against Mid-Century to Nunn, and in return Nunn agreed not to execute the judgment against James.

Nunn sued Mid-Century, and both the Colorado trial court and appellate court granted summary judgment in favor of the insurer, each finding that because James would never face personal liability for the judgment, James had no "damages" to assign to Nunn. Bad-faith claims require proof of actual damages as an essential element, and the lower courts found that James suffered none.

The Colorado Supreme Court Decision

The Colorado Supreme Court reversed the lower courts' decisions. It noted that these decisions would require the insured to first subject itself to "potential financial ruin" before it could protect itself by shifting the risk to the breaching insurer. This was inconsistent with Colorado's general recognition that an insured is permitted to take affirmative steps to avoid the "potentially disastrous" effects of its insurer's bad faith. One way an insured can protect itself from an insurer's bad faith is to do exactly what James did: stipulate to a judgment, assign the bad-faith claim to the third party, and secure the third party's agreement not to execute the judgment against the insured. If the bad-faith claim is held to be worthless because the insured is not personally liable, then third parties will never agree to stipulate judgments with covenants not to execute against the insured, and the insured will have to remain personally liable.

Moreover, the Colorado Supreme Court did not agree that the insured suffered no damages. The mere entry of judgment against an insured may result in damage to the insured's credit, reputation, or ability to obtain a loan. It also may cause fear, anxiety, or other distress.

Nunn, as the assignee, was allowed to pursue her bad-faith claim against Mid-Century, although she would have to prove that the stipulated judgment was reasonable. The jury would decide the proper measure of her damages.

Implications

This decision is a reminder to insurers that they cannot escape liability for their bad faith actions by requiring the insured to make a "Hobson's choice," where there really is no option, but the illusion of a choice to either accept or refuse the offer that is given to you. Insurers who improperly refuse to settle claims for an amount within policy limits can be liable for judgments in excess of policy limits, and the insured is not required to retain liability for that judgment in order to preserve the bad-faith claim against the insurer.

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