New Wisconsin Supreme Court Decision Scales Back the Consequences of One Insurer’s Breach of the Duty to Defend Where Multiple Carriers Provide Overlapping Coverage

Tuesday, February 12, 2019

Steadfast Insurance Company v. Greenwich Insurance Company, 2019 WI 9, decided by the Wisconsin Supreme Court on January 25, 2019, adds fire to the ongoing debate among insurance coverage counsel about the consequences of an insurer’s breach of the duty to defend. Does the decision suggest that a majority of the Court have now adopted the view expressed by Justice Prosser in Maxwell v. Hartford Union High School District, 2012 WI 58, that an insurer can assert policy defenses after breaching the duty to defend? While this question awaits a future decision by the Court, the Steadfast decision does change rules in matters involving a claim potentially covered by more than one insurer.

The Steadfast case arose out of the historic rains that occurred in Milwaukee in June, 2008. Raw sewage backed up into more than 8,000 homes and lawsuits were brought by homeowners against the Milwaukee Metropolitan Sewerage District (“MMSD”), United Water Services, LLC (“United Water”) and Veolia Water Milwaukee, LLC (“Veolia”). United Water and Veolia operated and maintained MMSD’s system by contract during different time periods. United Water was insured by Greenwich and Veolia was insured by Steadfast. Both policies named MMSD as an additional insured.

MMSD tendered the claims to both Greenwich and Steadfast. Steadfast participated in MMSD’s defense by reimbursing MMSD for $1.55 million in defense costs. Greenwich refused MMSD’s tender. MMSD’s renewed tender to Greenwich a year later was also rejected. The lawsuits against MMSD were eventually settled without MMSD paying any damages.

After the settlements, Steadfast brought a subrogation action against Greenwich to recover the $1.55 million in defense costs it had paid to MMSD. The circuit court granted summary judgment to Steadfast for the full $1.55 million, ruling that Greenwich waived its right to raise coverage defenses because it breached the duty to defend. The court also awarded Steadfast $325,000 in attorney fees incurred in the subrogation action. The Court of Appeals affirmed but with a different rationale, holding that Greenwich was not equitably entitled to an allocation of a share of the $1.55 million defense cost because it had breached the duty to defend.

In a majority opinion by Justice Roggensack, the Wisconsin Supreme Court affirmed in part, and reversed in part. First, with respect to the damages awarded for defense costs, the Court faulted the circuit court and Court of Appeals for ignoring the financial windfall to Steadfast of awarding damages for all of the defense costs when Steadfast had its own duty to defend MMSD. The Court held that when two insurers have the duty to defend the same claim and one insurer provides a defense but the other does not, “the financial sanction of an insurer who fails in its duty to defend does not include judicial forgiveness of another insurer’s financial obligation for defense cost.” Id. ¶ 41.

Accordingly, the Court next looked at how to allocate the defense costs between Steadfast and Greenwich and decided that the fairest method would be pro-rata, based upon the respective policy limits. This resulted in the
defense costs being allocated 60 percent to Steadfast and 40 percent to Greenwich.

On the issue of Steadfast's attorney fees, the Court agreed with the circuit court and Court of Appeals that Steadfast was subrogated to the rights of MMSD and, therefore, had the same right as MMSD would have had to an award of attorney fees if MMSD had successfully sued Greenwich for breaching its duty to defend. While noting that Wisconsin courts had not yet awarded attorney fees to a subrogated insurer for breach of the duty to defend, the Court found no persuasive reason to exclude “attorney fees from the bundle of rights that arise from a specific subrogation clause upon payment by the subrogee.” Id. ¶ 51.

In a separate opinion concurring in part and dissenting in part, Justice Ann Walsh Bradley joined by Justice Dallet criticized the majority opinion as being inconsistent with the preferred framework of requesting a judicial determination on coverage rather than making a unilateral decision to refuse to defend its insured. In Justice Bradley's view, “[r]ather than encouraging insurers to live up to their contractual obligations, the majority opinion allows insurers to rest comfortably in their decision to deny a defense with the knowledge that if a breach is later found, no financial consequence will be forthcoming.” Id. ¶ 72.

Justice Bradley also disagreed with the majority’s affirmance of the award of attorney fees. She decried the failure to heed the warning that exceptions to the American Rule are to be limited and narrow and concluded that allowing a subrogated insurer to recover attorney fees in a subrogation action against another insurer was not justified.

So, in Justice Ann Walsh Bradley’s view, the breaching insurer should have to pay the non-breaching insurer 100% of the cost incurred defending the insured, but would not be liable for attorney fees incurred by the non-breaching insurer to pursue subrogation.

Justice Rebecca Grassl Bradley also filed a separate opinion concurring in part and dissenting in part. While agreeing as a general matter that an insured’s defense costs should be allocated between insurers who have an overlapping duty to defend the insured, Justice Bradley would have reversed the judgment against Greenwich in its entirety based upon her interpretation of the Greenwich policy as being excess to the Steadfast policy.

Whether the Steadfast case represents a significant change in the law of the duty to defend will have to await future decisions. There is a clear distinction between an insured who is left hanging by an insurer who breaches its duty to defend and a fight between insurers. But the decision does change the considerations that can come into play when a claim is tendered to two insurers who have arguably overlapping coverage. Now, at least, those insurers have clear direction on how defense costs should be shared and the risks of denying coverage.

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