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DECLARATORY RELIEF: THE ANTIDOTE TO BAD FAITH

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I. HYPOTHESIS:

When coverage is questioned, the timely filing of a declaratory judgment action will reduce the insurance carrier's risk of an adverse bad faith judgment.

II. CAVEAT:

A. The hypothesis will not immunize a carrier against bad faith lawsuits or verdicts. Its purpose is to stimulate discussion and to alert insurance carriers and their counsel to the potential benefits of immediately filing a declaratory judgment action when coverage is disputed.

B. A declaratory judgment action will not protect a carrier from real bad faith, e.g., failing to acknowledge and timely

investigate claims; denying claims or coverage without conducting a reasonable investigation; failing to communicate honestly with its insured; failing to settle claims which, under all circumstances, should be settled; etc.

III. FIRST PARTY BAD FAITH.

First party bad faith claims assert that the carrier did not act in good faith or deal fairly in responding to the insured's claim for the benefits provided by the policy. Typical allegations are that the carrier failed to properly and timely investigate the insured's claim; failed to settle the claim when, under all the circumstances, it should have done so; or denied coverage without a reasonable basis. "The touchstone of bad faith liability" is unreasonableness in processing insurance claims." [1]

A. Factual disputes unrelated to coverage disputes are not a basis for declaratory relief as a defense against a bad faith claim. For example, when damages are contested in an uninsured motorist claim, the carrier's good faith reasonable belief that the

[1] Universal Life Ins. v. Giles, 950 S.W. 2d 48 (Tex. 1997) (Hecht, J., concurring).

insured's damages are less than the insured's demand can be resolved by arbitration or trial, pursuant to the policy terms. If the result is unfavorable to the carrier, the insured can pursue a bad faith action only by demonstrating that the carrier intentionally and unreasonably denied or withheld payment; the carrier's position was not fairly debatable;[2] the carrier's position was not the result of a good faith mistake; and the insured cannot be made whole by payment under the policy.[3]

B. However, where the carrier disputes coverage under a First Party Policy, a preemptive declaratory judgment action may provide protection against a bad faith claim. Consider the following example:

> An insured under a fidelity bond reports a loss caused by employee theft. The carrier does not agree as to the amount of the loss. More importantly, the carrier's investigation suggests that

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[2] The "fairly debatable" test varies with jurisdiction. For example, California uses the "genuine dispute" doctrine. See, e.g., Chateau Chamberay Homeowners Ass'n. v. Associated Int'l Ins. Co., 108 Cal. Rptr. 2d 776 (Ct. App.), *as modified on denial of reh'g,* 2001 Cal. App. LEXIS 587 (2001). Florida has abandoned the fairly debatable standard in favor of a legislative description, i.e. the carrier is liable if it does "not attempt in good faith to settle claims when, under all the circumstances, it could and should have done so, had it acted fairly and honestly toward its insured and with due regard for his…interests." See §624.155, Florida Statutes.

[3] Anderson v. Farmers Ins. Co. of Idaho, 947 P.2d 1003 (Idaho 1997).

> the loss was caused by poor business and accounting practices, not theft. Further, the carrier believes that the insured's statements on the fidelity bond application were fraudulent.

In this situation, the carrier should immediately file for declaratory relief. The insured may counterclaim but its damages will be limited to the amount of the theft loss. [4] If the carrier establishes that there was no coverage under the bond because there was no theft, or because of fraud, the carrier prevails. If the carrier loses those issues, the insured will recover his loss, plus attorneys' fees.[5] The insured is not estopped from filing a bad faith action seeking other damages. However, to prevail, the insured must demonstrate that the carrier's actions were unreasonable.

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[4] In most jurisdictions, an insured cannot assert a cause of action for bad faith until liability and damages for the underlying claim have been established. Vest v. Travelers Ins. Co., 753 So. 2d 1270 (Fla. 2000); But, note - some jurisdictions recognize a bad faith cause of action even in the absence of coverage if the carrier's acts violate state law or harm the insured. See, e.g., Deese v. State Farm Mut. Auto. Ins. Co., 838 P.2d 1265 (Ariz. 1992); Coventry Assoc., L.P. v. Am. States Ins. Co., 961 P.2d 933 (Wash. 1998).

[5] Most states have statutes awarding fees to an insured who is successful in a coverage action.

C. Consider, also, the following situation where the carrier's aggressive pursuit of a declaratory judgment would be helpful.

> An insured is injured by an uninsured motorist. He contends that his damages far exceed his uninsured motorist policy limits of $200,000 ($100,000 stacked coverage for two vehicles). He also contends that he has an additional $100,000 in coverage because he acquired a third car 30 days before the accident, which was not yet added to the policy (most automobile policies extend coverage for thirty days for additional cars). The carrier, concedes that the damages exceed $200,000. However, the carrier reasonably believes that the third vehicle was not covered because the insured did not give notice within 30 days of its acquisition, as required by the policy.

If the U/M claim goes to trial, there is a substantial risk of an award exceeding $200,000, or, perhaps, $300,000. A bad faith claim is certain to follow. The insured will seek the excess over the policy limits plus the typical bad faith damages. However, if the carrier tenders the $200,000 and seeks a declaration regarding its policy limits before the determination of the insured's damages, the carrier may obtain protection from a bad faith claim. The carrier has demonstrated good faith by offering what it reasonably

believes to be the policy limits and filed the declaratory judgment action to obtain a speedy resolution of the disputed coverage issue.

D. When the carrier disputes coverage in a first party claim the declaratory judgment strategy has potential benefits but little risk.

1. Benefits:

a. Carrier chooses forum;

b. Carrier, as plaintiff, puts on case first as "aggrieved party" before defendant can poison the well;

c. In most jurisdictions, the insured will not be permitted to file a bad faith counterclaim - it will be dismissed as premature.[6] This keeps the insured from seeking discovery of carrier's files;

d. If the carrier prevails on the coverage issue, the litigation ends and the insured's bad faith claim will be moot;

e. If the carrier loses the coverage issue, the carrier can promptly settle the claim for fair value, e.g. tender the theft loss in the fidelity bond example, or the extra $100,000 coverage

[6] See Supra note 4.

in the U/M example. With payment, it may be possible to obtain a release for bad faith;

f. Even if the carrier cannot obtain a release of the bad faith claim, it will have preserved and enhanced the value of certain defenses;

(i) The ultimate test for bad faith is whether the carrier acted reasonably in denying the claim. If the court deciding the declaratory judgment has denied the insured's motion to dismiss, summary judgment, or motion for directed verdict, the carrier can argue that the denial of coverage was fairly debatable, or subject to genuine dispute;

(ii) The carrier is not considered to be a fiduciary of the first party insured. The carrier is entitled to argue for an interpretation of the law and facts that is in its best interests;[7]

(iii). The carrier has the "right to be wrong" so long as it acted reasonably in denying the claim.[8] The insured

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[7] Morris v. Paul Revere Life Ins. Co., 135 Cal. Rptr. 2d 718 (Ct. App. 2003).
[8] This rule is explained in great deal in an article entitled "Good Faith as a Matter of Law - An Update on the Insurance Company's 'Right to be Wrong' "

bears the burden of proving that the carrier did not have a reasonable basis for denying the claim. In other words, the carrier's loss of the declaratory judgment action is not evidence of bad faith, so long as there is evidence that the carrier conducted a prudent investigation and had reasonable ground for denying coverage and filing suit. If the insured cannot show that the carrier's denial of coverage was unreasonable, the carrier should be entitled to summary judgment or a directed verdict against the bad faith claim.

(iv) The carrier's right to rely upon advice of counsel, while not dispositive, is admissible as a factor for the jury to consider on the issue of bad faith.[9] The carrier will be able to argue that its coverage position was reasonable because its counsel opined that there was no coverage and advised filing the declaratory judgment to resolve the issue.

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by Douglas G. Houser, Ronald J. Clark and Linda M. Bolduan in the Summer 2004 issue of Tort Trial and Insurance Practice Law Journal, Volume 39, Number 4.

[9] Cotton States Mut. Ins. co. v. Trevethan, 390 So. 2d 724 (Fla. 5th DCA 1980), rev. denied., 392 So. 2d 1373 (Fla. 1980). Caution: Utilizing this defense will open up counsel's files in discovery. Furthermore, if the carrier anticipates using this defense, it may be prudent to get a second opinion before filing the action for declaratory relief.

(v) The carrier should be entitled to a jury instruction that advice of counsel is a factor in determining bad faith. The lawyer who filed the declaratory judgment will be able to testify to the carrier's reasonable conduct in investigating and denying the claim. The lawyer can express his opinions that the weight of legal authority supported a denial of coverage; that he was satisfied that the carrier thoroughly and diligently investigated the claim before denying coverage, and that he recommended filing the declaratory judgment as a reasonable way to promptly resolve the dispute with the insured. As a witness, the lawyer handling the declaratory judgment action becomes an advocate for the carrier in the bad faith claim.

(vi) The carrier's "litigation conduct" in the declaratory judgment action is, generally, not admissible to prove bad faith;[10]

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[10] "Allowing litigation conduct to serve as evidence of bad faith would undermine an insurer's right to contest questionable claims and to defend itself against questionable claims…" Timberlake Const. Co. v. USF&G, 71 F.2d 335 (10th Cir. 1995); see also Levine Middlebrooks v. U.S. Fire Ins. Co., 639 So. 2d 606 (Fla. 1994). ("…absolute immunity must be afforded to any act occurring during the course of a judicial proceeding….")

IV. THIRD PARTY BAD FAITH.

Third party insurance is obtained for protection in the event the insured is sued (the "Underlying Action") and becomes obligated to pay for damages caused to a third party. Bad faith suits by the insured, or the third party, alleging that the carrier failed to properly investigate and settle the third party's claim against the insured within the policy limits are common. A declaratory judgment action will not reduce the risk of this type of claim. However, when the carrier reasonably contends that the policy does not provide coverage for the third party's claim, an early resolution of that issue benefits all parties.

A. Duty to Defend Policies. Duty to Defend Policies require the carrier to defend the insured, hire his lawyer, and pay any judgment up to the policy limits. Duty to Defend Policies allow the carrier to control the litigation, including the decision to settle. This places the carrier in a fiduciary relationship with the insured.[11] Therefore, it is perilous to deny coverage.

[11] State Farm Mut. Ins. Co. v. Laforet, 658 So. 2d 55 (Fla. 1995).

If the third party complaint alleges claims that the carrier contends are not covered by the policy, one option for the carrier is to decline coverage and refuse to defend. This choice increases the risk of a bad faith claim. The plaintiff and the insured may enter into a Coblentz Agreement.[12] The courts have recognized Coblentz Agreements where a carrier refuses to defend and leaves the insured to his own devices, provided the parties are acting reasonably and not in collusion.

In the Coblentz situation, the plaintiff and the insured settle for the highest justifiable amount, even if it exceeds policy limits. Judgment is entered, however, plaintiff agrees not to execute against the insured. The insured assigns his policy rights to the plaintiff. The plaintiff then brings the bad faith suit against the carrier, as judgment creditor and assignee of the insured's contract rights. If the plaintiff can establish coverage under the policy, the carrier will be obligated for the lower of the judgment amount or the policy limits. If the plaintiff can establish that

[12] Coblentz v. Am. Sur. Co., 416 F.2d 1059 (5th Cir. 1969).

coverage was denied in bad faith, the plaintiff will recover the judgment amount, even if it exceeds policy limits.

A safer practice for the carrier disputing coverage is to defend the insured under a reservation of rights and immediately file a declaratory judgment action to determine coverage. The carrier should name the third party plaintiff as a defendant in the action[13] and seek to have the underlying action stayed until the coverage issue is resolved. Consider the following example:

> The carrier issues an automobile liability policy to a car rental agency. A customer rents a car and drives to a dangerous location. While stopped at a light, an unknown assailant, in the course of a robbery, shoots and kills the customer. The customer's estate sues the car rental agency for negligently failing to warn the customer to avoid the dangerous location. The carrier believes that the agency is not entitled to coverage because the plaintiff's damages did not arise out of the use, ownership, or maintenance of the car. The negligence which was the cause of the damages occurred at the agency where the rental clerk failed to warn the customer.

[13] Allstate Ins. Co. v. Conde, 595 So. 2d 1005 (Fla. 5th DCA 1992) ("It is, of course, essential that the injured party be made a party to the declaratory judgment actions"); Independent Fire & Cas. Co. v. Paulekas, 633 So. 2d 1111 (Fla. 3d DCA 1994) (holding that a declaratory judgment obtained by the carrier is not binding on the third party plaintiff who was not a party to the action.)

Another example where the carrier would benefit from this strategy follows:

> Plaintiff sues his attorney for malpractice relating to a real estate transaction. Plaintiff alleges that the attorney gave bad advice in two separate opinion letters concerning different steps in the transaction. The malpractice policy provides for a one million dollar liability limit for damages arising out of a wrongful act, or interrelated wrongful acts.
>
> Plaintiff's damages exceed one million dollars. Plaintiff contends that each letter was a separate act of negligence causing damages and that the liability limits are two million dollars. The carrier contends that the letters are interrelated wrongful acts and, therefore, the liability limit is one million dollars.
>
> Plaintiff demands the lesser of three million dollars or the two million dollars liability limits to settle. The carrier will only offer one million dollars.

In this situation, going to trial is perilous. If the verdict exceeds one million dollars, the insured is exposed to an uninsured judgment. If the court later finds that the policy limits are two million dollars, the insured and the plaintiff will both contend that the carrier's refusal to settle was in bad faith and seek the excess one million dollars. If the court finds that the limits are one million dollars, the carrier may avoid a bad faith claim, but the insured is still exposed. Obviously, the carrier and the insured

would both have benefited if the liability limit had been determined before the trial of the underlying case.

With Duty to Defend Policies, even more difficult problems arise when the third party plaintiff alleges multiple claims, some of which are covered by the policy and some of which are excluded. In this situation, the carrier has an obligation to defend, which must be honored until the potential for coverage is totally excluded. If the carrier refuses to defend, even though some of the plaintiff's claims fall within the policy, it is reasonable to expect a Coblentz Agreement followed by a bad faith action.

Higgins v. State Farm, a recent Florida Supreme Court case,[14] addresses the potential benefit of an early declaratory judgment in the situation summarized below:

> The plaintiff sued Higgins, a State Farm insured, for assault and battery contending that Higgins beat and injured the plaintiff at the home of Bradley, Higgins' estranged wife. The Plaintiff then amended her complaint to soften these allegations. She claimed that Higgins was drunk and violently touched and injured her. The plaintiff, also, sued Bradley for negligence in failing to protect or warn her. State Farm had issued a homeowner's liability policy to Higgins for the premises where the

[14] Higgins v. State Farm Fire & Cas. Co., 2004 WL 2201474 (Fla. 2004).

> incident occurred. The policy excluded coverage for the intended or willful acts of an insured.
>
> State Farm immediately sued Higgins, Plaintiff, and Bradley for a determination as to whether it had the duty to defend and indemnify him contending that the exclusion precluded coverage. The court consolidated the plaintiff's action and State Farm's action. Plaintiff again amended her complaint alleging that Higgins "negligently" injured her. State Farm amended its declaratory judgment complaint to allege that Higgin's conduct was intentional and excluded from coverage notwithstanding the "negligence label" in plaintiff's complaint. The court tried the declaratory judgment action first and the jury found that Higgin's conduct was intentional. Plaintiff and Higgins both appealed.

The Florida Supreme Court held that the duty to defend is determined solely by the allegations of the complaint, regardless of the facts underlying those allegations. Thus, there is generally no need for a declaratory action to determine the duty to defend. The court also held that an insurer may pursue a declaratory action to determine the duty to indemnify, stating:

> We conclude that it is illogical and unfair to not allow insureds and insurers to have a determination as to whether coverage exists on the basis of the facts underlying a claim against an insurance policy. Why should an insured be placed in a position of having to have a substantial judgment against the insured without knowing whether there is coverage

> from a policy? Why should an insurer be placed in a position of either paying what it believes to be an uncovered claim or being in jeopardy of a bad faith judgment for failure to pay a claim?
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> ***
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> We agree with what Chief Justice Pariente stated as a judge of the Fourth District Court of Appeal, in *Britamco Underwriters, Inc. v. Central Jersey Investment, Inc.,* 632 So.2d 138, 141 (Fla. 4th DCA 1994):
>
> > Generally, an insurance carrier should be entitled to an expeditious resolution of coverage where there are no significant, countervailing consideration. A prompt determination of coverage potentially benefits the insured, the insurer and the injured party. If coverage is promptly determined, an insurance carrier is able to make an intelligent judgment on whether to settle the claim. If the insurer is precluded from having a good faith issue of coverage expeditiously determined, this interferes with early settlement of claims. The plaintiff certainly benefits from a resolution of coverage in favor of the insured. On the other hand, if coverage does not exist, the plaintiff may choose to cut losses by not continuing to litigate against a defendant who lacks insurance coverage. (Emphasis Supplied.)

Higgins also held that the trial court has the discretion to determine whether to try the declaratory action or the underlying action first and described the criteria which the court should consider.

One factor is whether the claims in the underlying action are mutually exclusive. For example, where the plaintiff is pleading alternate theories of negligence and intentional tort, early resolution of coverage is beneficial because the carrier must defend the insured until the covered portions of the complaint have been eliminated.

Another factor is whether a resolution of the insurance indemnity issue will promote settlement and avoid the potential for collusion between plaintiff and the insured to create coverage when, under the true facts, coverage does not exist. For example, an insured may not oppose the plaintiff on the covered claims because the plaintiff is entitled to a defense so long as those claims remain in the case. This puts more pressure on the carrier to settle, which benefits the plaintiff and the insured. If, however, the insured is financially capable of responding to any judgment that the plaintiff may obtain, it may prejudice the plaintiff to delay the underlying case until coverage is resolved.

There are cases throughout the country addressing other factors. In Pettit v. Erie Insurance,[15] the court noted that, under certain circumstances, a declaratory judgment action on coverage should be resolved before the underlying tort action. The court distinguished situations where denial of coverage is due to an issue collateral to the plaintiff's claim from situations where the coverage question depends on facts which will be decided in the underlying case. For example, if the carrier denied coverage alleging that the insured breached its duty to cooperate, the coverage defense is unrelated to the tort claim and should be resolved first.

Also, if the coverage issue may be determined as a matter of law, the declaratory judgment action should precede the tort case. In Petit, the minor plaintiff brought suit claiming sexual molestation by the insured. The plaintiff alleged various negligence theories such as negligent care of minor children, failure to warn, and failure to make the premises safe. Notwithstanding these theories, the court found that the factual

[15] Pettit v. Erie Ins., 699 A.2d 550 (Md. Ct. Spec. App. 1997).

allegations, as a matter of law, established plaintiff's intent to injure. Therefore, a declaratory judgment to resolve coverage before the trial of underlying case was appropriate.

In Alexander Underwriters General Agency v. Lovett,[16] the carrier, believing that its policy had been cancelled, refused to defend its insured. The third party plaintiff recovered a judgment in excess of the policy limits. The insured sued for the excess judgment, alleging that the carrier's refusal to defend or settle was caused by negligence, fraud or bad faith.

In affirming the bad faith judgment, the court noted that the "proper and safe course of action" for the carrier would have been to provide a defense under a reservation of rights and seek a declaratory judgment of no coverage; see also Litz v. State Farm Fire and Casualty Co.,[17] where the court noted that determining a declaratory judgment before the underlying action can be a "valuable and appropriate means" of resolving coverage if the coverage issue is independent and separable from the tort claims.

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[16] Alexander Underwriters Gen. Agency v. Lovett, 357 S.E.2d 258 (Ga. Ct. App. 1987).
[17] Litz v. State Farm Fire & Cas. Co., 695 A.2d 566 (Md. 1997).

However, if the factual issue to be resolved in the declaratory judgment will be decided in the underlying action, the underlying action should be tried first.

In Morgan v. Guaranty National Companies,[18] the court held that the carrier's declaratory judgment action to determine coverage could not be pursued after the carrier refused to defend its insured and the third party plaintiff recovered a judgment. However, the carrier was allowed to raise a lack of coverage defense to a post judgment suit by the insured or the plaintiff. The result in Morgan, preserves the carrier's coverage defenses. However, it is important to recognize that, if coverage is upheld, the carrier has lost the opportunity to negotiate a favorable settlement and must accept the jury verdict.

B. Indemnity Policies. The argument for filing a preemptive declaratory judgment action to determine coverage is stronger when an Indemnity Policy is at issue because the carrier is not required to provide a defense. The insured must hire his own lawyer (frequently, from a pre-approved panel) and controls the

[18] Morgan v. Guar. Nat'l Co., 489 S.E. 2d 803 (Ga. 1997).

defense. Note, however, that Indemnity policies may require the carrier to periodically reimbursement the insured for defense costs and the carrier usually reserves the right to consent to settlement.

Therefore, the prudent carrier should immediately provide a reservation of rights letter and honor the obligation to reimburse defense costs until the coverage issue is resolved. The carrier should also notify the insured that it will seek to recover the defense costs if there is no coverage; that the carrier demands to be kept advised of settlement negotiations; and that the insured should not enter into any settlement without the carrier's consent. Although Coblentz settlements typically occur with Duty to Defend Policies, the carrier's appropriate notification inhibits the insured and the plaintiff from settling for more than policy limits and pursuing a bad faith action for the excess.

V. ANOTHER CAVEAT

The strategy discussed above has not always met with success. In Guaranty National Insurance Company v. George,[19] the insured was sued for wrongful death arising from a vehicle

[19] Guaranty Nat'l Ins. Co. v. George, 953 S.W. 2d 946 (Ky. 1997).

crash. The carrier disputed whether the insured's vehicle was covered under the policy and provided a defense under a reservation of rights. Before the underlying case was resolved, the insured sued for bad faith. In the bad faith action, the carrier counterclaimed for a declaration of no coverage. The carrier lost the coverage issue. Immediately thereafter, the carrier settled the plaintiff's claim, and procured a release for the insured. The carrier then appealed the coverage decision, losing again. The insured continued to pursue the bad faith claim contending that the declaratory judgment action was filed in bad faith. The lower court entered summary judgment for the carrier but the intermediate appellate court reversed, holding that the allegation of bad faith was a jury issue.

The Supreme Court of Kentucky ultimately held that, under the facts of the case, it was not bad faith for the carrier to seek a determination of its legal obligation. Nevertheless, the court stated:

> Some may argue that the insurer, by notifying its insured that it is defending under a reservation of rights and filing a declaratory judgment action is automatically absolved of bad faith. We do not so

> hold. Clearly, one can envision factual situations where an insurer could abuse its legal prerogative in requesting a court to determine coverage issues. (emphasis supplied).

In Dalrymple v. United Services Automobile Assoc.,[20] the carrier filed a declaratory judgment action contending its policy did not provide coverage for the insured. The insured counterclaimed for bad faith. The court severed the claims and tried the coverage action before the counterclaim and before the underlying tort claim. The court determined that the policy provided coverage. The carrier then settled the underlying actions. Nevertheless, the insured pursued the bad faith counterclaim and received a jury verdict. The trial court held that the filing of the declaratory judgment action was a factor in considering whether the carrier acted in good faith and submitted the issue of whether the carrier had proper cause to the declaratory relief action, to the jury. On appeal, the California appellate court analogized the bad faith claim to malicious prosecution, holding that the plaintiff in an insurance bad faith case must prove the carrier acted without

[20] Dalrymple v. U.S. Auto. Assoc., 46 Cal. Rptr. 2d 845 (Cal. Ct. App. 1995).

proper cause and with malice in filing the declaratory judgment action.

The court noted that a carrier can erroneously dispute coverage without acting in bad faith, provided that it is acting reasonably. Thus, the filing of the declaratory action is to be judged under a "reasonable attorney" standard, i.e. was the declaratory action to resolve coverage legally tenable under the known facts, under the view of a reasonable attorney.

In Hillenbrand v. Insurance Company of North America,[21] the carrier suffered a disastrous result (14 million dollars punitive damage award, remitted to 3 million dollars) in a malicious prosecution action brought by an insured after the carrier had filed two declaratory judgment actions relating to coverage. In the underlying action, Hillenbrand was sued for damages caused by improper construction of a condominium. The carrier agreed to defend under a full reservation of rights based upon a policy exclusion relating to claims of faulty workmanship. The adjuster handling the case recommended filing the first declaratory

[21] Hillenbrand v. Ins. Co. of N. Am., 128 Cal. Rptr. 2d 586 (Cal. Ct. App. 2002).

judgment action regarding the carrier's duty to defend even though he opined that the carrier would lose the case. In that action, the carrier propounded discovery asking the insured to admit that the alleged construction defects were due to faulty workmanship. This, of course, exposed the insured to liability in the underlying case while simultaneously eliminating his coverage. The carrier then moved for summary judgment on the duty to defend issue. In this motion, the carrier's lawyers deliberately withheld information from the court concerning a recent case that favored the insured. The summary judgment was denied. The insured settled the underlying case, however, the carrier continued to pursue the declaratory judgment and filed a second claim to recover its fees.

On appeal from the malicious prosecution judgment, the court held:

1. The duty to defend is broader than the duty to indemnify and the insurer must defend if there is any potential the claim might be covered, even of the potential for coverage rests on facts known to the carrier and not set forth on the face of the complaint in the underlying case.

2. A declaratory judgment is the appropriate action for resolving coverage disputes. Nevertheless, a declaratory judgment can be maliciously prosecuted.

3. Declaratory relief actions during the pendency of the underlying action are not favored because they require the insured to defend two cases simultaneously and may prejudice the insured's defense of the underlying case.

4. The carrier knew that the declaratory action were frivolous because the carrier knew extensive facts which disclosed the potential for coverage and, thus, the duty to defend.

5. When there is a triable issue of fact in the underlying case, the carrier has the duty to defend the insured. Therefore, the carrier lacks probable cause to seek a declaration that there is no duty to defend.

While the Hillenbrand case would seem, to disprove the hypothesis, it is suggested that it merely emphasizes that a carrier must use caution in pursuing declaratory relief before the underlying action is resolved. Although the punitive damage award was affirmed, the court noted that the law encourages

carriers to seek declaratory relief to resolve coverage issues. However, in Hillenbrand, the carrier sought a declaration as to both its duty to defend and its duty to indemnify even though it knew it had a duty to defend. The carrier's motive was to force a settlement of the underlying case and its conduct throughout the litigation was reprehensible. Had the carrier merely sought a declaration of its duty to indemnify, the malicious prosecution action would not have been successful.

VI. DETERMINING INDEMNITY OBLIGATIONS AFTER RESOLUTION OF THE UNDERLYING CASE:

The hypothesis suggests pursuing declaratory judgment before the underlying case is concluded to determine coverage as strategy to reduce the carrier's risk of bad faith. It should also be noted that delaying the declaratory judgment until the underlying case is resolved may make it difficult to ultimately resolve indemnity disputes. For example, both the insured and the carrier are often motivated to settle the underlying case for economic reasons or to reduce risk. A settlement may prevent determination of factual issues necessary to resolve the indemnity

questions or allocate indemnity between the insured and the carrier on the basis of covered and non-covered claims. Therefore, the carrier will benefit if it is able to obtain an early declaration of coverage.[22]

VII. CONCLUSION:

Early resolution of coverage issues benefits the carrier. A timely declaratory judgment action is an effective way to determine the carrier's obligations and reduce the risk of bad faith claims that often follow a denial of coverage.

[22]Please see the comprehensive discussion of this issue entitled "Coverage Conundrum: Post-Settlement Determination of an Insurer's Indemnity Obligation" by William H. Black, Jr. in the Insurance Coverage Litigation Committee Newsletter, Winter 2005.