INSURED AND PRIMARY INSURER CANNOT JOIN A “MORRIS” AGREEMENT TO AVOID INSURER’S OBLIGATION TO PAY POLICY LIMITS

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Leflet v. Redwood Fire and Cas. Ins. Co.
Ct. Appeals, Div. One, January 20, 2011

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The lawsuit arose out of a construction defect class action that homeowners filed against the developer Hancock. Hancock in turn filed a third-party complaint against several subcontractors, asserting claims for breach of contract, breach of warranty, negligence and indemnity. Hancock and the subcontractors tendered their defenses to their respective insurers, all but one of which accepted the tenders under a reservation of rights. Hancock also tendered its defense to the subcontractors’ insurers, who were obliged under their policies to provide primary coverage to Hancock for claims arising from the scope of the subcontractors’ work.

Under the terms of the policies, Hancock’s insurance carriers furnished primary coverage to Hancock for its own liability and excess coverage for liability attributed to the subcontractors. The subcontractors’ insurers accepted Hancock’s tender under reservations of rights.

After substantial discovery, the court ordered the parties to mediation. Plaintiffs and Hancock attempted to enter into a Morris/Damron type agreement whereby Hancock agreed to pay Plaintiffs $375,000 – an amount well below its insurers’ policy limits – assign to Plaintiffs its rights against the subcontractors and their insurers, and to stipulate to a judgment in favor of Plaintiffs for an amount to be determined later. In exchange, Plaintiffs agreed not to execute the judgment against Hancock or its insurers.

The subcontractors and their insurers had no knowledge of the agreement, and thus challenged it, arguing a breach of the cooperation clause. The trial court agreed: the failure to notify the subcontractors and their insurers of the agreement breached the cooperation clause. The court thus entered judgment for subcontractors and their insurers, excusing them from having to defend and indemnify, and awarded them fees and taxable costs to be paid jointly and severally by the Plaintiff homeowners. The court of appeals affirmed. Not only had the cooperation clause been breached, but in addition, the agreement was invalid as outside the bounds of Morris.

Unlike a Morris situation, here Hancock did not act simply to protect itself from an excess verdict. It acted as an agent of its insurer that sought to limit its own liability and place the burden on the subcontractors’ insurers. Hancock’s interests were aligned with those of its insurers, not opposed to them. Also, unlike an insured defendant, a primary insurer who acts in good faith is subject to liability only to the extent of its policy limits, a risk for which it bargained and was paid. A primary insurer does not face the prospect of an excess judgment or a judgment within policy limits for which it might not receive coverage. Therefore an insurer that reserves its rights may not employ Morris to reduce its liability below policy limits, and an insured that facilitates such an effort breaches its duty to cooperate with its other insurers.

The court did, however, overturn the award of attorneys’ fees to the subcontractors’ insurers.