EXHIBIT A

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

CONTINENTAL CASUALTY COMPANY, an Illinois corporation, in its own right and as Subrogee of EDWARD C. LEVY COMPANY, a Michigan corporation,

Plaintiff,

vs.

GREAT AMERICAN INSURANCE COMPANY, an Ohio corporation,

Defendant.

No. 86 C 3938

Judge Brian C. Duff

MEMORANDUM OF LAW FOR TRIAL

INTRODUCTION

Insurance is an agreement whereby parties give valuable consideration for protection from and indemnification against loss, damage, injury, or liability. As servants of the public, insurance companies are held to the universally high standard of "good faith." Frankenmuth Mutual Insurance Company v Keeley, 433 Mich. 525, 447 N.W. 2d 691 (1989). A number of factors are considered by the courts in determining if an insurer is liable for bad faith dealing with its insured. Here, several factors show Great American's unquestionable bad faith. Among the indicia of bad faith, as defined by the Michigan Courts, are:

1) Failure to keep the insured and excess carrier fully informed of all developments in the claim or suit that could reasonably affect the interests of the insured;

2) Failure to inform the insured and excess carrier of all settlement offers that do not fall within the policy limits;

3) Failure to solicit a settlement offer or initiate settlement negotiations when warranted under the circumstances;

165

4) Failure to accept a reasonable compromise offer of settlement when the facts of the case or claim indicate obvious liability and serious injury;

5) Rejection of a reasonable offer of settlement within the policy limits;

6) Undue delay in accepting a reasonable offer to settle a potentially dangerous case within the policy limits where the verdict potential is high;

7) An attempt by the insurer to coerce or obtain an involuntary contribution from the insured or the excess carrier in order to settle within the policy limits;

8) Failure to make a proper investigation of the claim prior to refusing an offer of settlement within the policy limits;

9) Disregarding the advice or recommendations of an adjuster or attorney;

10) Serious and recurrent negligence by the insurer;

11) Refusal to settle a case within the policy limits following an excessive verdict when the chances of reversal on appeal are slight or doubtful.

Commercial Union Insurance Company v. Liberty Mutual Insurance Company, 426 Mich. 127, 393, N.W. 2d 161, 1565-166 (1986). It should be noted that Courts have recognized that when an insurer breaches its contract of insurance with its insured it also breaches a duty to the excess carrier. The excess carrier then assumes the rights and obligations of the insured.[1] Valentine v. Aetna Insurance Company, 564 F.2d 292, 297 (9th Cir. 1977); Peter v. Travelers Insurance Company, 375 F. Supp. 1347 (C.D. Cal. 1974).

---

[1] Michigan, in fact, recognizes the theory of equitable subrogation. Commercial union Insurance Company v Liberty Mutual Insurance Company, 426 Mich. 127, 393 N.W. 2d 161 (1986). The excess carrier, therefore, stands in the shoes of the insured. Allstate Ins. Co. v Citizens Ins. Co. of American, 188 Mich. App. 594, 325 N.W. 2d 505 (1982).

Furthermore, bad faith can exist "even though the insurer's actions were not actually dishonest or fraudulent." Commercial Union Insurance Co. v. Liberty Mutual Insurance Co., supra, 426 Mich. at 137, 393 N.W. 2d at 164.

Here, the undisputed facts illustrate clear indicia of Great American's bad faith on numerous fronts.

Moreover, Great American breached its contract of insurance to its insured and is also liable therefore to the excess carrier under subrogation.

FACTS

The Policies

Levy, a Michigan corporation, was insured by Great American, the defendant, under both a primary Comprehensive General Liability (CGL) policy, No. XO 485 8845[2] with limits of $1,000,000 per person, bodily injury liability and $1,000,000 per person, contractual bodily injury liability, and an Employer's Liability Workmen's Compensation (EL Policy, No. 104 16 77) with a limit of $100,000 per person. Levy was also insured by Continental under excess policy No. RDU 060 900 27, 87. All of the aforementioned policies were in effect on February 22, 1969. The Continental policy provided coverage above the Great American policy limits.

The Accident

On February 22, 1969, Frederick Denlar was injured while in the employ of Levy and while working at the Ford Motor Company

---

[2] All policies have been filed with this court and are a part of the record.

(hereinafter "Ford") plant in Dearborn, Michigan. Denlar, a truck driver, was driving a truck full of hot slag to be weighed on a scale designed, built and maintained by Levy. Ford owned the property and Levy used the premises pursuant to a contract with Ford. A ramp was constructed so as to allow dump trucks to drive up onto the scale. After weighing the truck, the driver was to drive off the scale by going forward down a similarly constructed ramp. When parked on top of the scale, the dump truck was six to ten feet above the surrounding ground.

An Investigation by Great American showed that inadequate space was allowed for a driver to alight and unsafe guard rails, all Levy's responsibility. Great American knew that the accident involving Denlar arose solely out of Levy's negligent operations.

Denlar was injured when he opened the door of his truck and attempted to exit. He fell and landed on concrete on his neck and severed his spinal cord. The accident rendered Denlar a quadriplegic, and ultimately resulted in his death in October, 1972.

The Indemnity Contract

Levy had contracted with Ford to haul steel slag from Ford's River Rouge Michigan plant. Pursuant to the written contract with Ford, Levy was to indemnify Ford for all personal injuries that resulted from the negligence of Levy or its agents. The contract also provided that Levy was to indemnify Ford for any loss arising from personal injuries that resulted from the combined negligence of Levy and Ford or their agents. The contract further provided

that Levy would hold Ford harmless from liability from such claims.

Great American was advised in 1976 that the indemnification agreement between Ford and Levy was valid and applicable to the Denlar accident insofar as its terms stated if Denlar were to recover against Ford. Great American was aware of the likelihood that Levy would be subject to an indemnification action if Ford were found liable to Denlar. Great American's investigation revealed that Levy built, operated, and maintained the premises under license from Ford. Great American was further aware that Ford's liability arose out of Levy's operation, and maintenance of those premises. Great American, therefore, knew that Levy, its insured, would have to indemnify Ford for any judgment that would be rendered in the Gage/Denlar v Ford suit.

Great American had been advised on August 5, 1976, by an independent attorney that Ford could be expected to pursue its indemnification rights against Levy.

Closing the File

Great American closed its file on August 1, 1977, despite the probability that its insured, Levy, would be exposed to an indemnity action by Ford. Great American notified Continental on May 28, 1978, that it had closed its claim file and that there was no reason for Continental to keep an open file. Thereafter, Great American next notified Continental on March 21, 1980, of the Ford v Levy suit.

The Underlying Lawsuit

William Gage, Administrator for the Estate of Frederick

Denlar, filed a lawsuit in 1974 against Ford Motor Company and Buffalo Scale Company in the Circuit Court of Wayne County in the State of Michigan under Case No. 74 025 590 alleging that Denlar's injuries resulted in his death on October 25, 1972, because of the negligence and breach of warranty by Ford and Buffalo Scale Company. Buffalo Scale was subsequently dismissed from the suit. Prior to trial on April 26, 1978, Ford attempted to file a third party action for indemnity against Levy. The trial judge refused to grant leave to file because of proximity to trial.

Great American's Knowledge and Lack of Settlement Offers

By August 5, 1976, Great American's investigation indicated Levy had sole and exclusive possession and control of the scale. Great American's regional claim manager at the time of trial believed that juries in Wayne County, Michigan, had a high propensity to return high verdicts in cases involving injuries of this nature and that a verdict against Ford in Gage/Denlar v Ford would probably be in excess of what Great American believed Levy's policy limits to be. Great American never made any firm settlement offers despite the fact that the case could have been settled for substantially less than the ultimate judgment. Great American never informed Levy of its exposure should Ford be found liable.

A $1.5 million verdict was rendered against Ford. Ford then filed suit against Levy for indemnity. Great American made no offers of settlement in this suit before summary judgment was granted in Ford's favor. (Ford v Levy)

Tender of Defense

On January 5, 1976, March 31, 1976, and November 15, 1978, Ford, through its attorney, Perry Seavitt, tendered its defense in Gage/Denlar v Ford to Levy pursuant to the contract between Levy and Ford, based upon Seavitt's representations that Denlar's injuries were sustained because of a dangerous and unsafe condition of the scale designed, built and maintained by Levy in its performance under the contract. Levy notified Great American of the tender by Ford prior to January 15, 1976, in order to comply with the provisions of the Great American policies and requested Great American to provide Levy with coverage under the applicable policies. Great American ignored the aforesaid tender until December 1, 1978, at which time it declined the tender. Such refusal to accept the tender was repeated on several subsequent dates.

On November 15, 1978, Ford made a demand on Great American to assume the defense of Ford, negotiate for settlement and pay any judgment in Gage/Denlar v Ford. At the same time, Ford informed Great American that the plaintiff's attorney, Stanley Schwartz, formally demanded $350,000 on November 7, 1978, in addition to Great American's waiver of its workmen's compensation lien in the amount of $125,000 to settle the Gage/Denlar v Ford case. Great American never informed Continental of this settlement demand.

On December 1, 1978, Great American refused to take over the defense of Ford, failed to negotiate any settlement and refused to pay any judgment in Gage/Denlar v Ford.

Settlement Opportunities

Great American did not waive its Worker's Compensation lien as a contribution to any settlement offer. Instead, Great American's representative, Reginald Johnson, assisted Gage's counsel in his action against Ford in order to collect Great American's lien, thereby working directly against the ultimate best interests of its insured, Levy. To pursue its own interests in the collection of its Worker's Compensation lien, Great American did not attempt to initiate a settlement.

A trial was held and on March 23, 1979, a judgment in favor of William Gage as Administrator of the Denlar Estate was entered against Ford in the amount of $1,500,000. Ford appealed the verdict in Gage/Denlar v. Ford and during the appeal, certain costs and interest were added to the original verdict, such that Ford satisfied a judgment in excess of $2,300,000. Part of that amount was used to repay Great American's lien plus interest on that lien. Even after the ruling against Ford in Gage/Denlar v. Ford, Great American refused to settle Ford's indemnity claim against Levy.

Ford v Levy Lawsuit

In February, 1980, Ford brought suit against Levy in the Circuit Court of Wayne County in the State of Michigan to recover what it had paid to satisfy the judgment in Gage/Denlar v. Ford. Great American provided and controlled the defense of Levy in this suit. On May 6, 1983, the trial court granted Ford summary judgment, finding that Levy was obligated to indemnify Ford in the

amount of $2,351,628.29, plus costs and interests. Great American, for Levy, appealed the summary judgment order to the State of Michigan Court of Appeals, which affirmed the order of the trial court on July 23, 1985, denying the appeal. On September 3, 1985, Great American, for Levy, applied for Leave to Appeal to the Supreme Court of Michigan. The State Supreme Court denied that application. During the pendency of the appeal process in Ford v. Levy, Great American made no attempt to negotiate a settlement.

To enable the appeal in Ford v Levy to proceed, Continental's Claim Supervisor Richard Hore signed an Affidavit of Recognizance stating that Great American had primary insurance for Levy of $1 million, that Continental had excess insurance of $4 million and further agreeing that Continental would pay that portion of the judgment over $1 million if the judgment against Levy was affirmed on appeal. Hore signed the affidavit only after repeated representations from Great American that it had only $1 million of applicable coverage. Had Hore not signed the affidavit, prepared by an attorney hired by Great American to represent Levy, the appeal could not have gone forward or Levy's assets would have been seized.

On January 17, 1984, Ted Williams of Continental advised Great American that Great American should pay the entire judgment against Levy because of Great American's bad faith and unreasonable conduct.

During the pendency of the appeal process in Ford v. Levy, Great American did not attempt to negotiate a settlement. The

amount of the judgment, plus interest and costs, ultimately amounted to $3,899,586.37.

On January 15, 1986, Ted Williams of Continental advised Great American again that Great American's applicable liability limits for Levy should be $2.1 million. Continental again stated that Great American should pay the entire claim due to Great American's bad faith.

Great American Did Not Pay Its Full Policy Limits or a Proper Portion of Interest Due

Great American did not pay any amounts under its Bodily Injury Liability Coverage or its Employer's Liability Coverage. It paid only the $1 million in coverage owing under its Contractual Liability coverage and $644,638.05 of the interest due. Continental paid $2,254,948.32 on behalf of Levy to satisfy the judgment that was in excess of the amount Great American paid to protect the insured, Levy.

Leonard Schwartz on May 5, 1986, was a partner in the law firm of Schwartz, Schwartz, Silver and Schwartz. His partner, Stanley Schwartz, had represented the plaintiff, Estate of Denlar, in the underlying case.[3] Despite this possible conflict, on March 14, 1986, Great American retained Attorney Leonard Schwartz to analyze and calculate Great American's obligation to pay the judgment against Levy and interest thereon. On May 5, 1986, Leonard Schwartz advised counsel for Ford that he had analyzed and

[3] David Tyler the attorney hired by Great American to represent Levy in Ford v Levy, had also been a partner of Stanley & Leonard Schwartz at the time Stanley Schwartz was retained to represent the Estate of Denlar.

calculated Great American's portion of the judgment and interest against Levy to be $1,644,638.05, and tendered same to Ford. On May 7, 1986, Continental attorney Richard Tonkin advised Leonard Schwartz that the figure of $2,360,272.96 was the principal judgment in the Ford v. Levy case. Tonkin also informed Schwartz that Great American had provided no one with copies of their policy.

Continental v. Great American Lawsuit

Continental brought suit in the U.S. District Court for the Northern District of Illinois, Eastern Division, on June 2, 1986, against Great American to recover all sums paid to Ford by Continental for Levy. In its Second Amended Complaint filed August 23, 1989, Continental alleges that Great American breached its contract by failing to pay all sums owing under Great American's policy and breached its duty of good faith toward Continental as excess carrier and its duty of good faith towards Levy, the insured, for whom Continental is a subrogee.

On April 27, 1989, Judge Brian Duff entered an Order on the parties' cross-motions for summary judgment whereby he found that Levy had been entitled to receive the benefits of both the $1 million Contractual Bodily Injury coverage and the $1 Million Bodily Injury Liability coverage of the Great American policy.

The Court further found that Great American had miscalculated its share of the interest on the judgment, having based it on $1 million coverage when as the Court found two coverages totalling $2 million was the correct base to determine pro rata shares. The

Court therefore found that Great American should have paid at least 85 percent of the post-judgment interest rather than the 42.5 percent that Great American had actually paid.

The Court also ruled on August 11, 1989, that Continental could amend its Complaint to add Breach of Contract counts. An Amended Complaint was filed on August 23, 1989, containing the additional counts.

I. ARGUMENT

A. GREAT AMERICAN ACTED IN BAD FAITH WHEN IT SIDED AGAINST ITS INSURED IN ITS ATTEMPT TO RECOUP ITS WORKMEN'S COMPENSATION LIEN

It is well established in Michigan that an insurer cannot maintain a separate suit against a third-party tortfeasor to recover workmen's compensation benefits paid to an employee after that employee has instituted its suit against the tortfeasor. Harrison v. Ford Motor Company, 370 Mich. 683, 122 N.W.2d 680 (1963). The reason for this rule is that the compensation insurer is the real party in interest and it, in essence, becomes plaintiff and defendant in the same suit. Id. "Insurer's position in the apparent role of a plaintiff ... which, as above noted, it would be to its interests to have defeated, would tend to be destructive of the adversary theory so essential to our system of administration of justice and arriving at truth and justice." Id. In fact, some jurisdictions have held that a counsel's representation that creates an appearance of impropriety warrants disqualification of the counsel in an action. Ettinger v. Cranberry Hill Corporation, 665 F.Supp. 368 (M.D.Pa. 1986).

Here, Great American's position on the plaintiff's side of the counsel table, against its insured, was unjust and amounted to a mockery of the adversary system. Great American, Levy's insurer, was in a position to use its knowledge and inside information against Levy. The interests of the insured and insurer were antagonistic in the action. "If the insurer is motivated by selfish purpose or by a desire to protect its own interests at the expense of its insured's interest, bad faith exists, even though the insurer's actions were not actually dishonest or fraudulent." Commercial Union Insurance Company v. Liberty Mutual Insurance Company, 426 Mich. 127, 393 N.W. 2d 161, 164 (1986).

Courts have held that a party may intervene in a third party action for the purpose of protecting its worker's compensation lien; however, such intervention cannot extend to that party's right to participate in the conduct or trial of the suit without the consent of the plaintiff. See, Sjoberg v. Joseph T. Ryerson & Son, Inc., 8 Ill. App. 2d 414, 132 N.E. 2d 56 (1st Dist. 1956). The Court there, though, observed that it is not necessary for a party to intervene before trial to protect its worker's compensation lien. Rather, it is sufficient that intervention be had after a jury verdict and before entry of judgment. Id. 8 Ill. App. 2d at 417. In other words, simply put, the same party cannot be both plaintiff and defendant at the same time. "It is incongruous that the same person should direct and conduct both the prosecution and the defense of the same suit, no matter in what capacity he may appear." Swope v. Swope, 173 Ala. 157, 164, 55 S.

418 (1914); See also, Globe v. Rutgers Fire Ins. Co. v. Hines, 273 F. 774 (2d Dist. 1921). Michigan, too, has recognized the injustice which results when one party, represented by insurance company attorneys, is permitted to proceed with an interest as both plaintiff and defendant. Vernan v. Gordon, 365 Mich. 21, 111 N.W. 2d 890 (1961). At the very least, defendant's conduct is subject to closer scrutiny because of his adverse interest while still representing the insured. Tennessee Farmers Mutual Insurance Company v. Wood, 277 F.2d 21, 25 (6th Cir. 1960); Cozzens v. Bazzani Building Company, 456 F.Supp. 192, 198 (E.D.Mich. 1978).

Here, defendant insurer's conduct upon close scrutiny reveals that Great American had only selfish reasons to sit at the counsel table representing Gage against Ford and ultimately against its own insured. Rather than waive its worker's compensation lien in an effort to settle the case, a case that should be settled, if at all possible, Great American representative Reginald Johnson assisted Gage's counsel in a selfish move to protect its own lien. Clearly, Great American did not give equal consideration to its insured's interests and acted in bad faith. Great American's success in getting its lien paid exposed Levy to the indemnity action by Ford.

B. GREAT AMERICAN ACTED IN BAD FAITH WHEN IT FAILED TO DEFEND ITS OWN INSURED IN ATTEMPTING TO RECOUP ITS WORKER'S COMPENSATION LIEN.

It is well established that a primary insurer bears the duty to defend its insured if there are any theories of recovery that fall within the policy. Dochod v. Central Mutual Ins. Co., 81 Mich. App. 63, 264 N.W. 2d 122 (1978). It is also accepted by the

courts in Michigan that when an insurer's duty of representing and defending its insured and the separate duty of assuming the burden of liabilities covered by the insurance contract come into conflict, or when the mere possibility of such a conflict becomes evident, the insurer must notify its insured clearly and promptly of the existence and nature of the conflict. Cozzens v. Bazzani Bldg. Co., 456 F. Supp. 192 (E.D. Mich. 1978). Under such circumstances, the duty to defend assumes ascendancy. Id. Failure to fulfill its duty to defend the insured means, under Michigan law, that the insurer becomes liable for the full amount of the judgment along with any fees incurred. Capitol Reproduction, Inc. v. Hartford Insurance Company, 800 F. 2d 617, 624 (6th Cir. 1986). "An insurer's duty to defend is independent of its duty to pay, and damages for breach of that duty are not limited to the face amount of the policy." Stockdale v. Jamison, 416 Mich. 217, 330 N.W. 2d 389, 392 (1982).

Courts have held that any conflicts of interest between an insurer and its insured will not relieve the insurer of its duty to provide a defense. Consolidated Rail Corporation v. Hartford Accident and Indemnity Company, 676 F. Supp. 82, 86 (E.D. Pa. 1987). One solution for an insurer is that it obtain separate, independent counsel selected by the insured. Id. Purdy v. Pacific Automobile Ins. Co. 157 Cal. App. 3d 59, 203 Cal. Rptr. 524 (2d Dist. 1984). Such would have been an appropriate solution here, yet it was not done. Instead, the insurer continued to represent the insurer while sitting across the table at an adversarial

proceeding. Great American never notified Levy of the inherent conflict between its own interest in collecting on the lien and Levy's interest in avoiding any exposure to an indemnity action by Ford.

Furthermore, the American Bar Association's Model Code of Professional Responsibility[4] has stated appropriate guidance on this issue. Canon 5 states: "A lawyer should exercise independent professional judgment on behalf of a client." The Second Circuit Court of Appeals has given this Canon some definition. "Where the relationship is a continuing one, adverse representation is prima facie improper ... and the attorney must be prepared to show, at the very least, that there will be no actual or apparent conflict in loyalties or diminution in the vigor of his representation." Cinema 5, Ltd. v. Cinerama, Inc., 528 F. 2d 1384, 1387 (2d Cir. 1976). (emphasis in original.) See also, Westinghouse Electric Corp. v. Kerr-McGee Corp., 580 F. 2d 1311, 1319 (7th Cir.) cert. denied, 439 U.S. 955 (1978). Suing and representing the same entities at the same time, at a minimum, evokes the appearance of impropriety. Ettinger v. Cranberry Hill Corporation, 665 F. Supp. 368, 372 (M.D. Pa. 1986).

Here, the specific terms of Great American's policy echo its obligation to defend its insured. In pertinent part it states:

> "With respect to such insurance as is afforded by this policy, the company shall: (a) defend any suit against the insured alleging such injury, sickness, disease or destruction and

---

[4] The ABA Code of Professional Responsibility has been incorporated by local Court Rule 6(b)(4) in Michigan.

seeking damages on account thereof, even if such suit is groundless, false or fraudulent; ..." (Great American policy, Insuring Agreements, Sect. II).

Here, Great American did not defend the interest of its insured. Instead, it rejected the tender of defense of Ford, despite knowing that an indemnity action against its insured was inevitable if Ford lost and that the injury arose out of Levy's negligence. Moreover, Great American then went so far as to take the opposite side of its insured in an effort to recoup its worker's compensation lien. In fact, a representative of Great American, Reginald Johnson, was seated at the counsel's table opposite to the ultimate interest of Levy in the underlying action, giving advice and support antagonistic to its own insured's best interests. Here, the appearance of impropriety indicates bad faith.

The facts here are similar to those in United States Steel Corporation v. Hartford Accident and Indemnity Company, 511 F. 2d 96 (7th Cir. 1975). There, the Court found a breach of the insurer's duty of fair dealing and duty to defend when the insurer, rather than fulfill its obligations when its insured became potentially liable in a third-party action, instead manipulated the theories of recovery so as to bring the third-party claim outside the scope of policy coverage. "Such a course of action was quite clearly not in [the insured's] best interest, since it assumed a less positive legal stance in the third-party action ..." Id. 511 F. 2d at 100, quoting the District Court's opinion on the matter. Here, Great American's breach of good faith is even more apparent

in siding against its insured.

II. GREAT AMERICAN ACTED IN BAD FAITH WHEN ITS ACTIONS FORCED CONTINENTAL TO CONTRIBUTE TO THE JUDGMENT BEFORE ITS PRIMARY LIMITS WERE EXHAUSTED.

It is elementary that an excess carrier does not contribute to a judgment until its primary carrier's limits are exhausted. Valentine v. Aetna Insurance Co., 564 F. 2d 292, 297 (9th Cir. 1977). Trying to get the insured, or here, the excess carrier, to contribute to a settlement within the policy limits is generally regarded as evidence of bad faith. Lanferman v. Maryland Casualty Co., 222 Wis. 406, 267 N.W. 300 (1936).

> "Excess insurance is routinely written in the insurance industry with the expectation that the primary insurer will conduct all of the investigation, negotiation and defense of claims until its limits are exhausted ... Thus, the primary insurer acts as a sort of deductible and the excess insurer does not expect to be called upon to assist in these details. The duty of the primary insurer is not divisible or limited to those suits that are within the policy limits and the insuring agreement creates a duty to defend any suit regardless of the amount claimed against the insured and the excess insurer is a third party beneficiary of that agreement."

Certain Underwriters of Lloyd's v. General Accident Insurance Company of America, 699 F. Supp. 732, 740 (S.D. Ind. 1988), quoting, 7C Appleman, Insurance Law and Practice, sect. 4682 (1979).

Here, it is without question that Continental, as the excess carrier, was forced to contribute to the judgment before Great American's primary policy limits were exhausted. Not only did Great American misinform Continental of its policy limits, it would

not provide copies of its policies to Continental so that the excess carrier could determine the true primary limits. Great American understated its policy coverage despite the clear language in its own policies and endorsements. It then had affidavits of written recognizance drawn to that effect, upon which Continental relied to its detriment. Great American claimed it provided only $1 million in applicable primary coverage when, in reality, it had provided $2 million. The amount of the judgment plus interest and costs ultimately amounted to $3,899,586.37. Great American paid only $1 million and $644,638.05 of the interest due. Continental, though, paid $2,254,948.32 on behalf of its insured, contributing $1 million that should have been paid by Great American plus a disproportionate amount of the interest thereon. Such conduct on the part of Great American amounted to bad faith.

III. GREAT AMERICAN ACTED IN BAD FAITH WHEN IT FAILED TO ENTER INTO SETTLEMENT NEGOTIATIONS AND EFFECTUATE A SETTLEMENT.

The Supreme court of Michigan has defined the bad faith of a primary insurer for failing to settle a claim against the insured as the insurer acting arbitrarily, recklessly, indifferently or with intentional disregard of the interests of the excess insurer. Commercial Union Insurance Company v. Liberty Mutual Insurance Company, 426 Mich. 127, 393 N.W. 2d 161 (1986); see also, Jackson v. Saint Paul Mercury Indemnity Company, 339 F. 2d 40 (6th Cir. 1965). In fact, in Michigan, it is well settled that an insurer is duty bound to settle the claim which its investigation shows is meritorious. Riley v. State Farm Mut. Automobile Insurance

Company, 420 F. 2d 1372 (6th Cir.), cert. denied, 399 U.S. 928 (1970). In other words, a primary insurer has an affirmative duty to explore settlement possibilities and it acts in bad faith when it does not do so. Self v. Allstate Insurance Company, 345 F. Supp. 191 (M.D. Fla. 1972). The covenant is implied in an insurance contract that neither party will do anything to injure the rights of the other in receiving the benefits of the agreement; such covenant includes a duty to settle claims without litigation in appropriate cases. Koyman v. Farm Bureau Mutual Insurance Co., 315 N.W. 2d 30 (Iowa 982). In fact, Michigan courts have held that when an insurer has the independent or exclusive negotiating power of the insured to settle the claim, the insurer has a positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage. Jones v. National Emblem Insurance Company, 436 F. Supp. 1119 (E.D. Mich. 1977).

The Sixth Circuit has put it as:

> An insurer, having assumed control of the right of settlement of claims against the insured, may become liable in excess of its undertaking under the policy provisions, if it fails to exercise good faith in considering offers to compromise the claim for an amount within the policy limits; and it is liable for an excess over the policy limit, where it has exclusive control over the investigation and settlement of claims, and its refusal to settle within the policy limit is in bad faith. [citations]

Tennessee Farmers Mutual Insurance Company v. Wood, 277 F. 2d 21, 24 (6th Cir. 1960).

Here, Great American's policy provided for the insurer to have exclusive control to settle claims. It provided, in pertinent

part:

> II. Defense, Settlement, Supplementary Payments
>
> With respect to such insurance as is afforded by this policy, the company shall: (a) defend any suit against the insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient;

The policy goes on to read:

> The insured shall cooperate with the company and, upon the company's request, shall attend hearings and trials and shall assist in effecting settlements, securing and giving evidence, obtaining the attendance of witnesses and in the conduct of suits. The insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense ...

Great American's policy, Condition No. 12. (emphasis added.)

It is clear from this language that although Great American maintained full control over settlement negotiations, it never properly considered viable and reasonable settlement offers in a case that clearly involved a probable excess verdict. Nor did Great American initiate any negotiations. Such conduct amounts to bad faith under Michigan law. In the underlying case, plaintiff's attorney made a demand to settle the case for $350,000 plus waiver of the Worker's Compensation lien. Great American never accepted the reasonable offer. Great American attempts to isolate the waiver of the lien from the "fresh money" portion of the demand. They claim that the failure to waive the lien did not in and of itself prevent settlement of the case. This reasoning, however, is

specious because after Great American failed to waive their lien, all settlement negotiations broke off and were never resumed. Their conduct, therefore, eliminated all possibility of settling the case.

IV. GREAT AMERICAN ACTED IN BAD FAITH WHEN IT FAILED TO INFORM CONTINENTAL OF ALL SETTLEMENT DEMANDS PRIOR TO TRIAL, OF ITS CONFLICT OF INTEREST REGARDING THE WORKER'S COMPENSATION LIEN, AND OF ITS PRIMARY POLICY LIMITS.

Courts have recognized and protected certain interests of an insurance contract either by implying a duty in the insurance contract or by establishing a common law duty. Duty is defined generally as conformity to a legal standard of reasonable conduct in light of the apparent risk. W. Prosser and W. Keeton, Handoob of the Law of Torts, Ch. 9 Sect. 53 at p. 356 (5th ed. 1989). Among such duties of an insurer is the obligation to inform the insured of all settlement possibilities.

In Jones v. National Emblem Insurance Company, 436 F. Supp. 1119 (E.D. Mich. 1977), the Court found that in situations where bad faith may be an issue, certain standards should be heeded by insurance companies:

> [I]t is clear that the insurer has a duty promptly and clearly to inform the insured of: (1) the possibility of a judgment in excess of the policy limits; (2) the insured's right to retain independent counsel; (3) the limits of the insurer's interest in the lawsuit; and (4) all settlement offers, including the insurer's response to such offers and the legal significance of those responses expressed in terms of the insured's liability. The extent and clarity of such notice by the insurer to the insured is a substantial factor to be weighed in determining whether the insurer handled settlement negotiations in good faith.

Id., 436 F. Supp. at 1124-1125. (Emphasis added.)

A majority of courts have held that the failure to advise is sufficient to allow recovery.[5] State Farm Mutual Auto Insurance Company v.. Jackson, 346 F. 2d 484 (8th Cir. 1965); Critz v. Farmers Insurance Group, 41 Cal. Rptr. 401, 230 C.A. 2d 788 (1964); Northwestern Mutual Insurance Co. v Farmers Insurance Group, 76 Cal. App. 3d 1031, 143 Cal. Rptr. 415 (1978); Ging v. American Liberty Insurance Company, 423 F. 2d 115 (5th Cir. 1970); Kooyman v. Farm Bureau Mutual Insurance Co., 315 N.W. 2d 30 (Iowa 1982); Roberie v. Southern Farm Bureau Casualty Insurance Company, 250 La. 105, 194 So. 2d 7713 (1967); Larson v. Anchor Casualty Company, 249 Minn. 339, 82 N.W. 2d 376 (1957); National Farmers Union Property & Casualty Company v. O'Daniel, 329 F. 2d 60 (9th Cir. 1964); Kaudern v. Allstate Insurance Co., 277 F. Supp. 83 (D.N.J. 1962); Goings v. Aetna Casualty & Surety Company, 491 S.W. 2d 847 (Tenn. 1972); Howard v. State Farm Mutual Auto. Insurance Company, 60 Wis. 2d 224, 208 N.W.2d 442 (1973); Western Casualty & Surety Company v. fowler, 390 P. 2d 602 (Wyo. 1964). Some courts have considered the failure to advise the insured of settlement as evidence of bad faith. Koppie v. Allied Mutual Insurance Company, 202 F. 2d 599 (6th Cir. 1952); Younger v. Lumberman's Insurance Company, 202 N.W. 2d 844 (Iowa 1973); Strode v. Commercial Casualty Insurance

---

[5] In cases where the duty to advise extends to the insured, under principles of equitable subrogation, the excess carrier stands in the shoes of the insured and is afforded the same protections and rights. Mich. Comp. Laws Ann. Sect. 600.1405 (1967); Allstate Insurance Company v Citizens Ins. Co. of America, 118 Mich. App. 594, 325 N.W. 2d 505 (1982).

Company, 202 F. 2d 599 (6th Cir. 1952); Younger v. Lumberman's 174 So. 2d 672 (La. 1965). Failure to advise the insured of settlement demands also may be indicative of indifference and, thus, of bad faith. Henke v. Iowa Home Mutual Casualty Co., 250 Iowa 1123, 1131-32, 97 N.W.2d 168, 179 (1959); 7C Appleman, Insurance Law & Practice, S. 4712 at pp. 432, 444, 470, 487 (1979).

A primary insurer also has the duty to provide its insured, and, thus, the excess carrier with sufficient information to allow them to make intelligent decisions concerning their exposure. See, eg., Bailey v. Prudence Mutual Casualty Co., 429 F. 2d 1388 (7th Cir. 1970); cf., Radcliffe v. Franklin National Insurance Company of New York, 298 P. 2d 1001 (Ore. 1956). Notice to an excess carrier is of critical importance. Sisters of Divine Providence v. Interstate Fire & Casualty Co., 117 Ill. App. 3d 158, 453 N.E. 2d 36 (5th Dist. 1983). See also, Greyhound Corp. v. Excess Insurance Co., 233 F. 2d 630 (5th Cir. 1956); Home Indemnity Co. v. Williamson, 183 F. 2d 572 (5th Cir. 1950). This is particularly the case, as here, where the strong possibility of an adverse verdict in excess of the primary limits exists. See, Domangue v. Henry, 3954 So. 2d 638 (La. App. 1980); Davy v. Public National Insurance Company, 5 Cal. Rptr. 488, 181 Cal. App. 2d 387, (1960). The insurer must keep its insured informed of any adverse developments in the investigation. Ivy v. Pacific Auto Ins. Co., 156 Cal. App. 2d 652, 320, p. 2d 140 (1958); Howard v. state Fam. Mutual Auto Ins. Co., 208 N.W. 20442 (Wisc. 1973).

Michigan courts as well have recognized the insurer's duty to

inform the insured of all settlement offers and to advise of its policy limits. Jones v. National Emblem Insurance Co., 436 F. Supp. 1119 (E.D. Mich. 1977). These same rights extend to the excess carrier who may sue a primary carrier directly as the real party in interest. (See Section IX herein.) An insurer's failure to do so is a factor constituting bad faith. Commercial Union Insurance Company v. Liberty Mutual Insurance Co., 4226 Mich. 127, 393 N.W. 2d 161 (1986).

Here, the underlying case involved a quadriplegic plaintiff who ultimately died. The verdict reasonably was expected to exceed the primary insurer's limits. Yet, Great American did not inform CONTINENTAL of all offers of settlement nor even of its policy limits. On November 7, 1978, Stanley Schwartz, plaintiff's attorney in Gage/Denlar v. Ford, demanded $350,000 and waiver of Great American's worker's compensation lien amounting to about $125,000, in order to settle the case. Great American never informed Continental of this settlement demand. Continental, therefore, was deprived of an opportunity to protect its interests.

The facts here are startingly similar to those in Roberie v. Southern Farm Bureau Casualty Insurance Company, 250 La. 105, 194 So. 2d 713 (1967), where the court held the insurer acted in bad faith.

> [H]e [the insured] was never apprised of the offers of compromise nor warned of his potential liability; he was ignored. He needed information and advice on the point of his potential liability, which he was not given by his representative, his insurer. A conflict of interest arose between the insurer and the insured. The insurer failed to

> discharge its duty towards its insured, thereby precluding any decisive action on his part." Id., 194 So.2d at 716.

Here, the insured and excess carrier were treated by Great American in much the same way.

The duty to inform also extends to the insurer's potential adverse interests. Herges v. Western Casualty and Surety Company, 408 F. 2d 1157, 1162, n. 7 (8th Cir. 1969), and cases cited therein. Great American did not inform Levy or Continental of its potential adverse interest in collecting its worker's compensation lien. This also amounted to bad faith.

V. THE POSSIBILITY OF AN ADVERSE VERDICT WAS GREAT HERE IN THAT THE TORT PLAINTIFF SUFFERED SEVERE INJURIES, YET GREAT AMERICAN IGNORED ITS DUTY TO SETTLE.

It is a well recognized principle that when the probability of an adverse finding on liability is great and when the amount of damages would greatly exceed the coverage, the insurer has a duty to settle. Kavanaugh v. Interstate Fire & Casualty Co., 35 Ill. App. 3d 350, 342 N.E. 2d 116 (1st Dist. 1975); Phelan v. State Farm Mutual Automobile Insurance Co., 114 Ill. App. 3d 96, 448 N.E. 2d 79 (1st Dist. 1983). The Sixth Circuit has recognized that where the weight of evidence is against the insured on the issues of damages, liability is an important factor determining whether the insurer should have settled. Noshey v. American Automobile Insurance Co., 68 F. 2d 808 (6th Cir. 1969). In fact, under Michigan law, part of the definition of bad faith is whether the primary carrier refused to accept a settlement offer within its policy limits when the risks of rejecting settlement were out of

proportion with the chance of a favorable verdict. Commercial Union Insurance Company v. Liberty Mutual Insurance Company, 137 Mich. App. 381, 357 N.W. 2d 861, 866 (184). aff'd, 426 Mich. 127, 393 N.W. 2d 161 (1986). As a California court put it:

> When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interests requires the insurer to settle the claim. Its unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing.

Commercial Union Assurance Companies v. Safeway Stores, Inc., 26 Cal. 3d 912, 164 Cal. Rptr. 709, 712, 610 P.2d 1038 (1980).

Here, as stated earlier, the tort plaintiff was paralyzed and ultimately died from his injuries. Great American also was aware of the propensity of juries in Wayne county to grant extraordinary verdicts in such cases. Yet, Great American rejected a reasonable settlement offer within its policy limits. It initiated no serious settlement talks and never informed Continental of settlement offers. Clearly, such conduct constitutes bad faith under Michigan law.

VI. GREAT AMERICAN, AS THE PRIMARY CARRIER, DID NOT GIVE EQUAL CONSIDERATION TO THE INTERESTS OF ITS INSURED OR THE EXCESS CARRIER, CONTINENTAL.

It has been held that an insurer who issues a policy of the type at issue here is under a fiduciary duty to look after the interests of the insured as well as its own interests. National Farmers Casualty Co. v. O'Daniel, 329 F. 2d 60 (9th Cir. 1964). "Failure to do so is bad faith and renders the company liable for

its breach of fiduciary duty in the amount of any judgment over the policy limits." Id., 329 F. 2d at 64-65. This level of consideration is often expressed by the courts as whether the insurer gave equal thought to the insured's interests. Tennessee Farmers Mutual Ins. Co., 277 F. 2d 21 (6th Cir. 1960); Continental Casualty Company v. Reserve Insurance Company, 307 Minn. 5, 238 N.W. 2d 862 (1976). This is particularly the case where the primary policy limits may be exceeded. Ballard v. Citizens Casualty Co. of New York, 196 F. 2d 96, 102 (7th Cir. 1952); Cernocky v. Indemnity Ins. Co. of North America, 695 Ill. App. 2d 196, 216 N.E. 2d 198 (2d Dist. 1966). The question to ask here is whose interests were deemed paramount, the insurer's or the insured's, when the company rejected an offer of settlement. It is clear here that the insured's interests were sacrificed.

Here, the matter could have been settled for much less than the verdict prior to trial by the primary insurer, Great American. On November 7, 1978, the attorneys for the injured plaintiff's estate, Stanley Schwartz, submitted a formal demand for settlement of the underlying action on behalf of the estate in the amount of $350,000 plus a waiver of the $125,000 worker's compensation benefits paid to or on behalf of the injured employee, the tort plaintiff in the underlying action. Great American rejected this offer, a demand well within its limits. A verdict of $1.5 million was rendered. Great American itself collected its entire lien plus interest out of that verdict. Therefore, a significant part of Continental's payout was made to reimburse Ford for amounts paid to

Great American.

Great American knew and was fully aware of the probability of an excess verdict, particularly given previous jury awards in Wayne County, the very serious injuries and ultimate death as a result of those injuries. Mr. Denlar left a wife and five children. Yet, Great American did not respond affirmatively to a reasonable settlement offer within its primary limits. It did not inform Levy or Continental of the offer. Rather, in an arbitrary, reckless, indifferent and intentionally selfish manner, it disregarded the interests of plaintiff, the excess carrier, knowing that it would be Continental who would carry the loss of Great American's bad faith. It was Continental's money with which Great American was gambling, knowing that its losses would be finite if it could cover up its bad faith actions well enough. See, La Rotunda v. Royal Globe insurance Co., 87 Ill. App. 3d 446, 408 N.E. 2d 928 (1st Dist. 1980). "The size of the judgment recovered ... when it exceeds the policy limits, although not conclusive, furnishes an inference that ... acceptance of an offer within those limits was the most reasonable method of dealing with the claim." Northwestern Mut. Ins. Co. v. Farmers' Ins. Group, 76 Cal. App. 3d 1031, 1054, 143 Cal. Rptr. 15 (1978), and cases cited therein.

Here, Great American neglected its duty, under Michigan law to settle a meritorious claim. In examining the reasonable valuation of the case, particularly given the propensity of juries in Wayne county to award exorbitant verdicts in such cases, Great American

acted indisputably in bad faith in failing to effectuate a settlement. In doing so, the financial interests of the excess carrier or insured were given no consideration.

VII. CONTINENTAL DID NOT WAIVE ANY RIGHTS IN SIGNING THE AFFIDAVITS OF WRITTEN RECOGNIZANCE.

In order for a party to waive its rights, it must have intentionally and knowingly relinquished those rights. American Locomotive Co. v. Chemical Research Corp., 171 F.2d 115 (6th Cir. 1948); Commercial Union Insurance Company v. Medical Protective Co., 136 Mich. App. 412, 356 N.W. 2d 648 (1984), aff'd in pertinent part, 426 Mich. 109, 393 N.W. 2d 479, (1986). When one party has done something having the effect of deceiving and misleading the other party, courts consider it inequitable to enforce against the latter the alleged right of such other party. Shean v. U.S. Fidelity & Guaranty Company, 263 Mich. 535, 248 N.W. 892 (1933).

Here, Continental did not waive its right to claim that $2 million of coverage existed. First of all, it was Great American's lawyers who drew up the affidavits of written recognizance upon which Continental reasonably relied to its detriment. To enforce this right against CONTINENTAL now would be inequitable. This is particularly the case in that Great American representatives have admitted that the affidavits held no legally enforceable rights but, rather, were done so only to expedite the appeals process for the insured. Continental was forced to sign the Affidavit in order to protect its insured.

For Continental to waive its right to claim the proper amount of coverage, it must do so intentionally and knowingly. It signed the affidavits at a time when Great American would not even provide CNA with copies of the appropriate policies. Therefore, CNA could not knowingly relinquish any rights without having the proper information before them, information which had been repeatedly requested but denied by Great American. Therefore, Great American's argument is not only improper but it only serves to lend credence to CNA's contention of Great American's bad faith exhibited throughout this case.

The policy forms were Great American's forms. Great American at all times knew or should have known what coverage it provided. It cannot be logically assumed that anything Continental did could have mislead Great American about its own coverage. Great American's refusal to supply its own policy forms to Continental or even its own field personnel should be taken as an indication of intentional concealment.

Moreover, it is inconsequential what Great American representatives thought about the affidavits because waiver involves the act and conduct of only one of the parties regardless of the attitude of the other party. See, Estoppel and Waiver, 28 Am. Jur. 2d Sect. 30 at p. 634 (1966). Continental representatives never intended the signing of the affidavits to constitute a waiver of any rights. Because of Great American's concealment of its policy forms, Continental could not know what rights it had and no waiver was even possible.

EVIDENCE OR INSINUATION OF CONTRIBUTORY NEGLIGENCE OR COMPARATIVE FAULT ON THE PART OF CONTINENTAL IS INADMISSIBLE AND MUST BE PROHIBITED FROM THE JURY'S CONSIDERATION

Evidence or insinuation of contributory negligence or comparative fault on the part of Continental is inadmissible. Caselaw specifically addressing the issue prohibits the introduction of such evidence, and by implication, removes consideration of this issue from jury deliberation.

Although no reported Michigan case has addressed the admissibility of evidence of contributory negligence against an excess insurance carrier in an action for bad faith, other jurisdictions considering the issue have held such evidence is not admissible.[6] Most recently in Continental Casualty Company v. Royal Insurance Company of America, 219 Cal. App. 3d 111, 268 Cal. Rptr. 193 (1990) the California Court of Appeals held that a primary liability insurer which has reserved to itself the right and duty to defend could not raise an excess insurer's lack of participation in the underlying defense, and alleged acquiescence at an affirmative defense to an action brought by an excess insurer for the primary insurer's bad faith in conducting settlement negotiations. Continental v. Royal, 268 Cal. Rptr. at 197.

---

[6] As this Court is no doubt well aware, the Michigan Supreme Court, particularly in the area of bad faith litigation has relied heavily upon the decisions of other jurisdictions in considering numerous issues which arise in such litigation. See e.g., Commercial Union Insurance Company v. Liberty Mutual Insurance Company, 476 Mich. 127, 393 N.W. 2d 161, 164-166 (1986).

Specifically the Court in Continental v. Royal held:

> There is no authority that holds an excess carrier should be charged with making sure the primary carrier fulfills its good faith obligations to the insured. Evidence of Continental's conduct including evidence of industry custom and practices was not relevant under these circumstances.

Continental v. Royal, 268 Cal. Rptr. at 197.

In Continental v. Royal, the Court relied in part upon Certain Underwriters of Lloyds v. General Accident Insurance Company, 699 F. Supp. 732 (S.D. Indiana 1988). In that case the trial court, interpreting Indiana law held that in an action for bad faith brought by an excess insurer the affirmative defenses of comparative fault and contributory negligence were not available to the primary insurer. Certain Underwriters v. General Accident, 699 F. Supp. at 741-742. In particular, the Court specifically held that there simply is no duty upon the excess insurer to actively participate in settlement negotiations. The introduction of evidence of the excess carriers conduct is irrelevant, and the admission of such evidence would only serve to confuse and prejudice the jury. Certain Underwriters v. General Accident, 699 F. Supp. at 742; see also, Continental v. Royal, 268 Cal. Rptr. at 197. Similarly, in the instant case the introduction of such evidence must be barred.

Respectfully submitted,

BRINTON & FEDOTA

150 North Wacker Drive
Suite 900
Chicago, Illinois 60606
312/236-5015