

10th Circuit Allows Insurer to Avoid Bad Faith Claim By Settling with Claimant and Pursuing Recovery from Insured

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Insurance Coverage and Bad Faith Alert

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Yesterday, the 10th Circuit endorsed a clever way for an insurer to avoid a bad faith claim where there were potential misrepresentations in the policy application. In *Evanston Insurance Company v. Aminokit Labs, Inc.*, the court affirmed a decision of the United States District Court for the District of Colorado, which allowed an insurer to settle a claim and pursue the insured for reimbursement of all the costs associated with the claim in a separate action. *Evanston Insurance Company v. Aminokit Labs, Inc.*, No. 19-1065, 2020 U.S. App. LEXIS 8571 (10th Cir. Mar. 18, 2020).

Aminokit Labs arose out of a lawsuit against an addiction treatment center in Colorado, in which a patient alleged consumer protection and racketeering claims against the insured relating to inpatient treatment received at the facility. After the insurer denied coverage, the underlying plaintiff amended his complaint to include negligence and vicarious liability claims against a doctor and the treatment center, potentially bringing the claim within the scope of coverage.

Following the amendment, the insurer agreed to defend the lawsuit, subject to a reservation of rights, which advised that there was no coverage afforded for the suit. After defending the matter for six months, a mediation was held involving the underlying plaintiff, the insured and the insurer. The insurer initially declined to pay the full settlement because it contended that a number of uncovered claims existed. However, after the insured's attorney threatened to bring a bad faith claim, the insurer agreed to fund the full settlement. It also made clear that if it settled the case, it would "seek reimbursement for the entire cost of defense and indemnity." The insured continued to demand that the insurer fund the whole settlement, which the insurer did, reserving its right to seek full reimbursement.

Prior to this mediation, the insurer had filed a declaratory judgment action, seeking a declaration of no defense or indemnity coverage. After funding the settlement, the insurer amended its complaint to include counts for unjust enrichment, fraudulent misrepresentation and fraudulent concealment. The fraud claims were related to misrepresentations in the application, where the insured represented that it did not perform inpatient treatment. The insurer sought damages for the fraud, including the settlement payment and defense costs.

The insured filed a motion to dismiss, which was denied, and default judgment was ultimately entered in favor of the insurer for the settlement payment, defense costs and prejudgment interest. The insured appealed.

On appeal, the insured argued that the insurer failed to state a claim for fraud because (1) it could not show the damages element, (2) it did not impact the insurer's decision to settle the case, and (3) because the insurer knew of the fraud when it made the decision to settle.

The 10th Circuit disagreed with the insured. The court held that it would have been economically unreasonable for the insurer to refuse to pay the settlement because it then would have been placed at risk of a bad-faith lawsuit. The court also emphasized a state public policy against insurance fraud, and allowing the insureds to retain the benefit of insurance coverage, even when fraudulently obtained, would foster insurance fraud. Thus, the court affirmed the judgment entered in favor of the insurer against the insured.

This case offers insurers a novel playbook to avoid bad faith claims. Specifically, if bad faith is at issue, *and the insured is solvent*, it provides an insurer the opportunity to fund the settlement and seek recovery from the insured. While it may not be ideal to have to pay and chase, doing so may prove better than risking litigation of a bad faith claim.

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