

***INSURER'S WRONGFUL FAILURE TO DEFEND GIVES RISE
TO BREACH OF CONTRACT ACTION***

In *Mesmer v. MAIF*, No. 50 Sept. Term, 1966 (filed 3/11/99) Maryland's highest court held that an insurer's refusal to defend gives rise to a breach of contract only and the damages are limited to policy limits plus attorneys fees and expenses incurred in defending the underlying suit. The insured will not be permitted to recover the amount of the excess judgment in the underlying suit.

In *Mesmer*, the insured obtained an auto policy from the Maryland Automobile Insurance Fund ("MAIF"). The insured and her daughter were both listed as operators of the 1981 Buick on which the policy was originally issued. When the insured obtained a new car, titled to the insured's boy friend, she notified MAIF and a new policy was issued, with the insured's daughter listed as the primary driver of the new vehicle. While operating the new vehicle in a negligent manner, the insured's daughter became involved in an accident that resulted in serious injury to Peggy Lyons. MAIF conducted an investigation of the claim and learned that the insured was not the owner of the vehicle listed on the policy. On this basis, MAIF declared the policy void and refused to provide a defense in the underlying tort action. A jury entered judgment against the insured's daughter in the amount of \$19,563,203.00. The insured's daughter, joined by the plaintiff in the underlying tort suit, filed a declaratory judgment against MAIF, seeking to recover the entire amount of the judgment, as well as costs in the underlying suit. The trial court found that MAIF breached its duty to defend, but awarded plaintiffs the \$20,000.00 policy limits and attorneys fees only.

The Maryland Court of Appeals affirmed, holding that an insurer's failure to defend, whether on the grounds that there is no valid insurance contract or that there is no coverage

under the contract, gives rise to a breach of contract action against the insurer. After a comprehensive review of Maryland contract law, the Court confirmed that when a “dispute is over the existence of any valid contractual obligation covering a particular matter, or where the defendant has failed to recognize or undertake a contractual obligation whatsoever, the plaintiff is ordinarily limited to a breach of contract remedy.”

The Court drew a careful distinction between those claims which sound exclusively in contract and those which give rise to a potential tort action. “It is when the [insurer] has proceeded on the basis that a contractual obligation exists, has undertaken that obligation, and has undertaken it with violation of the appropriate standard of care, that the plaintiff may, in some circumstances maintain a tort action.” Thus, an insurer’s bad faith failure to settle a claim for which it has undertaken the defense of the insured will give rise to a tort action. In such a situation, the insured may be entitled to recover the amount of judgment against the insured which exceeds the policy limits. Maryland has long held that recovery of the excess on a bad faith failure to settle claim is justifiable based upon the independent tort duty arising from the potential conflict of interest when the insurer undertakes defense and assumes control of the suit against the insured.

Where the insurer denies coverage and refuses to undertake the duty to defend, however, there has been no independent tort duty. Thus, an insurer’s wrongful refusal to tender a defense gives rise to an action in contract. The insured will be entitled to recover only the amount of the policy limits, plus the attorney’s fees and expenses in the underlying suit. The insured will not be permitted to recover the excess judgment rendered in the underlying suit. Hence, the Court affirmed the trial court’s limited award of \$20,000.00 policy limits, plus the \$9,673.95 cost of defending the underlying suit.

The *Mesmer* decision provides a clear and concise rule regarding the remedies available to the insured upon an insurer's wrongful failure to provide a defense.

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