

Recent Developments in the Law

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In the case *Mesmer v. Maryland Automobile Insurance Fund*, 353 Md. 241 (1999), the Court of Appeals of Maryland held that an insured may not recover from her insurer for a judgment in excess of policy limits in an underlying negligence action when the insurer refused to defend the suit on the insured's behalf.

The issues before the Court of Appeals were whether Mesmer's action against MAIF sounded in contract, tort, or both, and what were the appropriate amount of damages.

Denise Mesmer was involved in an automobile accident with Peggy Lyons in Washington, D.C. on February 22, 1990. The automobile Mesmer was driving was insured by MAIF, with personal injury liability coverage limits of \$20,000.00 per person and \$40,000.00 per accident. The automobile was titled in the name of Mesmer's mother's fiancé. However, the insurance policy erroneously listed both Mesmer and her mother as operators of the automobile and her mother as the named insured.

After two (2) months investigating the accident, MAIF voided the policy ab initio as of January 31, 1990 stating that there was not an insurable interest in the automobile. Counsel for the Plaintiff offered to settle the case against Mesmer with MAIF for MAIF's policy limits of \$20,000.00 but MAIF declined to settle the case since it maintained that the automobile Mesmer was driving did not qualify as an insured vehicle. Neither Mesmer nor the Plaintiff brought a declaratory judgment action to challenge MAIF's position that there was no coverage. Suit was filed in the Superior Court for the District of Columbia against Mesmer. MAIF was not named a party to the suit. At the conclusion of the following trial, judgment was entered against Mesmer for over \$19.5 million.

The instant case was filed in the Circuit Court for Montgomery County alleging MAIF was responsible for the full amount of the District of Columbia judgment, attorney's fees, and other damages, based on alleged breach of contract and negligence. On a motion for summary judgment, the circuit court ruled that MAIF had a contractual duty to defend Mesmer and awarded her \$20,000.00 plus attorney's fees. The plaintiffs then filed a petition for a writ of certiorari in the Court of Appeals of Maryland which was granted prior to consideration of the case by the Court of Special Appeals of Maryland. *Mesmer v. Maryland Automobile Insurance Fund*, 342 Md. 633 (1996).

Affirming the decision of the circuit court, the Court of Appeals held that a liability insurer's mistaken refusal to provide any defense on the grounds that there is no valid insurance contract or that there is no coverage under an insurance contract, only provides the basis for a suit based on breach of contract, not an action in tort. The Court did not, however, reach the issues of whether MAIF enjoys sovereign immunity from tort claims asserted against it and whether the Maryland Tort Claims Act furnishes the only tort remedy against MAIF.

The Court reasoned that insurance policies are treated just like other contracts in Maryland. It stated that it is well-settled in Maryland that "not every duty assumed by contract will sustain an action sounding in tort." *Council of Co-Owners v. Whiting-Turner*, 308 Md. 18, 32, 517 A.2d 336, 343 (1986). Moreover, the duty giving rise to a tort action must have some independent basis because a contractual obligation alone does not create a tort duty. *Heckrotte v. Riddle*, 224 Md. 591, 595-96, 168 A.2d 879, 881-82 (1961). Although the Court recognized that there was no single test for determining when a defendant's breach of a contract will also breach an independent duty and give rise to an action in tort, it opined that when the "defendant has proceeded on the basis that a contractual obligation exists, has undertaken that

obligation, and has undertaken it in violation of the appropriate standard of care, that the plaintiff may, in some circumstances, maintain a tort action."

The Court then distinguished that a liability insurer's breach of the insurance contract by erroneously disclaiming coverage only gives rise to a breach of contract action while a liability insurer's undertaking to defend against a claim and its bad faith failure to settle the claim within policy limits gives rise only to a tort action. *Sweeten, Adm'r. v. Nat'l Mutual*, 233 Md. 52, 194 A.2d 817 (1963); *State Farm v. White*, 248 Md. 324, 332-33, 236 A.2d 269, 273 (1967); *Allstate Ins. v. Campbell*, 334 Md. 381, 396-97, 639 A.2d 652, 659 (1994). The Court emphasized that a tort action can only arise when the liability insurer acknowledges coverage, or proceeds as if there were coverage, and undertakes to provide a defense to the insured. In the case before the Court, MAIF did not acknowledge coverage, nor did it act as if there were coverage.

The Court then moved on to the issue of the amount of damages. Affirming the amount of damages determined by the circuit court, the Court of Appeals held that under the laws of Maryland, "the insurer's contractual undertakings in a typical liability policy are to provide the insured with a defense and to indemnify the insured for a judgment up to policy limits." It further held the damages for a breach of these contractual promises "are the insured's defense expenses, including attorney [sic] fees, and the amount of an underlying tort judgment against the insured up to policy limits." The Court reasoned that because the insurer makes no promise that it will settle a claim within the policy limits, no breach of contract damages are available for violating any such contractual promise. The Court reiterated that any duty to settle within policy limits is "strictly a tort duty which only arises when the insurer undertakes to provide a defense." Thus, the damages for breaching that duty may only be recovered in an action sounding in tort.

In dicta, the Court noted that the insureds and tort claimants were not without a remedy in this situation. Had they brought a declaratory judgment action against MAIF to determine the coverage issue, MAIF would have been required to undertake a defense and "[u]pon MAIF's undertaking that defense, the tort duty to act in good faith to settle the claim within policy limits would have arisen."