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Full Clarity on Partial Releases

How to Navigate a Primary Insurer's Duty of Good Faith

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When the value of a liability claim clearly exceeds the primary insurance limit, but the excess insurer is not quite ready or willing to settle, tensions can arise as to how long the primary insurer must incur defense costs when it is prepared to pay its own limit. Typically, the law prohibits a primary insurer from paying its own limits to "cut and run" if the overall claim against the policyholder remains unsettled. However, certain states expressly allow such a primary insurer to use its limits toward a "partial settlement" with the claimant, thereby keeping the claim alive against both the excess and primary insurer as well as the policyholder (although the policyholder's personal assets become protected). The extent to which a primary insurer can avail itself of this law—and the recourse an excess insurer may have against the primary, if any—is highly fact- and state-dependent.

What Is a Partial Release?

A partial release allows a primary insurer to pay some or all of its limit of liability in exchange for a "partial settlement" that releases the primary insurer and releases all claims against the policyholder's personal assets. In other words, the claimant's suit can continue, but damages are only collectible against the excess insurer.

While a primary insurer is generally not permitted to "partially" settle a case and leave an excess insurer fully on the hook, some courts—including those in New Jersey, Indiana, Louisiana and Washington—have recognized the validity of partial releases. Why? The theory is that partial releases serve the public policy of encouraging settlement and protecting the insured from personal liability.

The terms of such releases, though, are governed by state law and can vary from state to state. For example, in Louisiana, a partial release—commonly known as a *Gasquet* release in reference to *Gasquet v. Commercial Union Ins. Co*.—must include a credit for the full amount of the primary limits in order for the claimant to then pursue the defendant's excess insurer, although the primary insurer does not have to actually pay its full limits. In contrast, Washington requires the primary insurer to actually pay its full limit of liability before the claimant can pursue the excess carrier, as settled in *Rees v. Viking Ins. Co. Thus*, a prudent primary insurer contemplating a partial release must carefully review and comply with the law of the applicable jurisdiction.

Partial Release Applicability

If a primary insurer is obligated to pay defense costs outside its policy limit, those costs can of course reach multiples of the indemnity limit, with no cap in sight. In a case where the primary insurer believes the value of the claim may be well beyond its limits, the primary insurer is highly motivated to pursue a partial settlement to protect the insured and to eliminate the primary insurer's defense spending.

Where the claim exposure could potentially run through all layers of insurance, or when part of the claim may not be covered, a policyholder faces the threat of personal liability. The primary insurer that negotiates a partial settlement can extinguish this exposure for its policyholder. For example, if a potential judgment could include uncovered punitive damages or fines and penalties, a policyholder may advocate for a partial release to protect their personal assets from exposure.

Avoid Partial Release Pitfalls

A partial release serves the interests of the primary insurer by insulating it from bad-faith accusations related to the failure to settle the claim and potentially cutting off defense costs. But it also serves the interests of the insured since it protects their assets from exposure.

This may sound like a win/win for the primary insurer and the insured. There is, however, the excess carrier to consider. Specifically, a prudent primary insurer that is considering a partial settlement with the claimant and the insured should attempt to include the excess carrier in the settlement negotiations. Otherwise, the excess insurer left exposed may later claim that the primary insurer breached its obligations to the excess insurer by failing to adequately notify the excess insurer of potential exposure to its excess limits.

The excess carrier may also argue that the primary carrier improperly placed its own interests ahead of the excess carrier's interests, exposing the excess carrier to damages by excluding it from the settlement negotiations.

On the other hand, a primary insurer likely can proceed with a partial release without risking a bad-faith claim when the excess carrier has disclaimed coverage and declined to participate in any settlement. In *Deblon v. Beaton*, the New Jersey Superior Court upheld a partial release where an excess carrier declined to negotiate in settlement discussions, finding that the excess insurer could not complain about the partial settlement "after disclaiming and refusing to negotiate at all."

The proper procedure is less clear when, for example, the excess insurer has reserved rights but not declined coverage. Given that many states have not explicitly approved the use of partial releases, it is unclear whether a primary insurer's effort to protect its insured's personal assets and transfer its defense obligations to an excess insurer would be permitted in a state that has not specifically approved such tactics. In fact, many excess policies contain contractual terms that could prohibit such unilateral shifting of defense obligations. Therefore, although a partial settlement may be a judicially created or statutory settlement tool in some states, in others such an effort to reach a settlement that carves out the excess layers may violate the very terms of the insurance contract.

Partial releases may offer primary carriers that are hamstrung by endless defense costs in high-value cases some relief. Insurers, however, should be wary of the strict requirements in certain states, as well as the potential for bad-faith accusations should the primary insurer not involve the excess insurers in settlement discussions. As a matter of practice, an insurer considering a partial settlement should always advise any excess insurers of the settlement discussions and give the excess insurer an opportunity to participate.