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Bad Settlement Decisions Can Be Costly: Nevada Recognizes Excess Carrier Bad-Faith Claims

Blog Avoiding Insurance Bad Faith

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Introduction

Earlier this year, the Nevada Supreme Court issued a significant decision for insurers, policyholders, and coverage counsel in *North River Insurance Company v. James River Insurance Company* ***[1]***. In a matter of first impression, the Court held that an excess insurer may pursue a primary insurer through equitable subrogation when the primary carrier allegedly fails to accept a reasonable settlement opportunity within its policy limits, even when the underlying action ultimately settles within the combined limits of the primary and excess policies. By answering a certified question from the Ninth Circuit, Nevada joined the growing majority of jurisdictions recognizing that excess insurers should have a remedy when they are forced to fund losses allegedly caused by a primary carrier's unreasonable settlement decisions.

The Nevada Supreme Court's Decision

The dispute arose from a wrongful death action involving a fatal shooting at Shelter Island Apartments in Las Vegas. James River Insurance Company insured the risk under a $1 million primary liability policy, while North River Insurance Company provided a $10 million excess policy. During the underlying litigation, the claimants made several settlement demands at or below James River's policy limits, including demands of $1 million, $990,000, and $975,000. James River declined those opportunities to settle. The plaintiffs later increased their demand to $5 million, and the case ultimately settled for that amount. James River paid its $1 million limit, while North River contributed the remaining $4 million under protest and reserved its reimbursement rights.

After North River funded the $4 million excess portion of the settlement, it sued James River in federal court, alleging that James River unreasonably refused multiple opportunities to settle within its $1 million policy limits and that North River was entitled to pursue the insured's bad-faith claim through equitable subrogation. The district court dismissed the action, concluding that Nevada law barred an equitable subrogation claim where the underlying lawsuit settled within the combined limits of available insurance. North River appealed, and the Ninth Circuit certified the issue to the Nevada Supreme Court, recognizing that the case presented important questions concerning insurers' settlement obligations and excess insurers' ability to pursue reimbursement after contributing to a settlement.

The central question presented to the Nevada Supreme Court was whether an excess insurer may pursue equitable subrogation against a primary insurer when the underlying case settles within the combined limits of available insurance.

The Court answered that question in the affirmative. It held that equitable subrogation allows an excess insurer to step into the insured's shoes and assert any claim the insured could have pursued against the primary carrier. If the insured could have brought a bad-faith failure-to-settle claim, the excess insurer that paid the loss may do so as well.

Importantly, the Court rejected the argument that equitable subrogation is unavailable simply because the insured suffered no out-of-pocket loss. The relevant inquiry is whether the insured would have suffered a loss absent the excess insurer's payment. Because the insured would have been responsible for the portion of the settlement exceeding the primary limits had North River not contributed, the Court concluded that equitable subrogation remained available.

The Court also emphasized the policy considerations supporting its ruling. Allowing excess insurers to pursue reimbursement promotes fair settlement practices, discourages primary insurers from rejecting reasonable settlement demands, and prevents primary carriers from shifting the consequences of poor settlement decisions to excess insurers. The Court noted that relieving primary insurers of accountability whenever excess coverage exists could distort incentives and ultimately increase insurance premiums.

The California District Court's Subsequent Ruling

Following the Nevada Supreme Court's decision, the Ninth Circuit reversed the dismissal and remanded the case to the Central District of California. On remand, the district court concluded that the Nevada decision eliminated any material conflict between Nevada and California law regarding equitable subrogation and held that North River had sufficiently alleged that James River's rejection of a $975,000 settlement demand, despite warnings that the claim exceeded its $1 million policy limits, forced North River to contribute $4 million toward settlement. Finding those allegations sufficient to state a claim, the court denied James River's motion to dismiss and allowed the case to proceed.

Practical Guidance for Primary Insurers

The combined effect of the Nevada Supreme Court's decision and the California district court's remand ruling should prompt primary insurers to reevaluate their claims-handling and settlement practices in high-exposure cases.

First, primary carriers should carefully evaluate policy-limits settlement opportunities when liability appears reasonably clear and the likely exposure exceeds available limits. A rejection of a reasonable settlement demand may now create direct exposure not only to the insured but also to excess carriers that later fund the loss.

Second, insurers should thoroughly document their settlement analyses. Claims files should memorialize liability assessments, damages evaluations, reserve decisions, settlement authority discussions, and the reasons for accepting or rejecting settlement demands. Contemporaneous documentation may become central evidence in any later bad-faith litigation.

Third, primary carriers should not assume that the presence of excess insurance eliminates their exposure. The Nevada Supreme Court expressly rejected the notion that excess coverage insulates a primary insurer from responsibility for unreasonable settlement decisions.

Fourth, primary insurers should maintain regular communication with excess carriers whenever a claim appears likely to penetrate excess layers. Early coordination regarding settlement demands, mediation opportunities, liability assessments, and case valuation may help avoid later disputes concerning claims handling and settlement conduct.

Finally, insurers should always share a demand with the insured and request their input about whether it should be accepted.

Conclusion

The Nevada Supreme Court's decision in *North River Insurance Company v. James River Insurance Company* represents a significant development in Nevada insurance law. The Court confirmed that an excess insurer may pursue a primary insurer through equitable subrogation for an alleged bad-faith failure to settle, even when the underlying action resolves within the combined limits of the available insurance coverage.

The subsequent California district court ruling underscores the practical significance of that holding. Once the Nevada Supreme Court clarified the law, the federal court allowed North River's claim to move forward, finding the allegations sufficient to support an equitable subrogation action.

For primary insurers, the message is straightforward: reasonable settlement opportunities deserve careful consideration and thorough documentation. Nevada law now makes clear that a primary carrier cannot avoid scrutiny merely because an excess insurer ultimately funds the settlement. When a carrier declines a reasonable opportunity to settle within policy limits, it may face not only criticism of its claim handling, but also direct litigation from the excess insurer that ultimately paid the loss.

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