

Alabama Liability Insurance Law Guide

Insurance Policy Interpretation Rules

Ambiguities

Any ambiguity in an insurance contract must be construed liberally in favor of the insured. Similarly, exceptions to coverage must be interpreted as narrowly as possible in order to provide maximum coverage to the insured. If there is no ambiguity, courts must enforce insurance contracts as written and cannot defeat express provisions in a policy, including exclusions from coverage, by making a new contract for the parties.

Plain Language Rule

Where questions arise as to the meaning of an undefined word or phrase, a court should give the undefined word or phrase the same meaning that a person of ordinary intelligence would give it. The terms of a policy should be given a rational and practical construction. A court must consider the policy as a whole and not consider the language in question in isolation.

Occurrence Rules

Modified Subjective Intent

Occurrence-based policies provide coverage for accidents resulting in “property damage” or “bodily injury.” “Bodily injury” or “property damage” that is “expected” or “intended” by the insured are not covered occurrences. An injury is “intended” if the insured possessed the specific intent to cause bodily injury to another. An injury is “expected” if the insured subjectively possessed a high degree of certainty that bodily injury to another would result from his act. However, the mere fact an injury is foreseeable does not make it “expected” as this would broadly eliminate coverage for negligent conduct.

Mental Anguish as Bodily Injury

In Alabama, “bodily injury” includes mental anguish or emotional distress.

Property Damage

Intangible or economic losses are not “property damages” under Alabama law.

Number of Occurrences

All damage resulting from one uninterrupted chain of causation constitutes one “occurrence.” Where two unrelated causes — distinguishable in time and space — cause damage, multiple “occurrences” will be found.

Trigger of Coverage

The time of an “occurrence” is not the time the wrongful act was committed, but the time the complaining party was actually damaged.

Duty to Defend

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The insurer owes a duty to defend if: (a) the complaint against the insured alleges a covered occurrence; or (b) the evidence in litigation proves a covered occurrence. If there is any uncertainty as to whether the complaint alleges facts that would invoke the duty to defend, the insurer must investigate the facts surrounding the incident that gave rise to the complaint in order to determine whether it has such a duty. When a complaint alleges both acts covered under the policy and acts not covered, the insurer is under a duty to at least defend the allegations covered by the policy. A court is not constrained to the allegations of the underlying complaint and may look to additional facts if they are proven by admissible evidence.

Failure to Defend

When an insurer elects not to defend, it does so at its peril. If a plaintiff changes his or her theory of liability from the theory or theories stated in the original complaint and asserts a claim against the insured that is covered by the policy, it is very possible the insurer will have to step in and defend the insured and/or pay the judgment.

Insured's Duty to Provide Notice

Whether or not reasonable notice has been given to the insurer depends on two factors: the length of time from the occurrence until notice to the insurer and the reasons for any delay in giving notice. Delays as short as four to six months have been found to be unreasonable. Depending on the circumstances of the delay, an insurer may avoid coverage if the delay in notice is unreasonable. The insurer need not show prejudice caused by the delay.

Reservation of Rights

Reservation of Rights Letters

An insurer is obligated to indemnify an insured if it undertakes the defense without first reserving the right to later deny coverage. Generally, the insurer gives notice by a reservation of rights letter. By sending such notice, an insurer can fulfill its duty to defend without waiving its right to later contest coverage. This letter must go to the named insured and all possible insureds.

Enhanced Obligations of Good Faith

Where the insurer assumes the defense under a reservation of rights, the insurer does so under an enhanced obligation of good faith toward its insured. The enhanced duty of good faith has implications both for the insurer and defense counsel retained by the insurer. The insurer's conduct must meet four specific criteria: (1) a thorough investigation of the accident and the claimed injuries and damages; (2) the retention of competent defense counsel of the insured, with the understanding that the insured is defense counsel's only client; (3) fully informing the insured of the reservation of rights defense, the progress of the suit, developments relevant to the insured's coverage and all settlement offers made by the insurer; and (4) refraining from any action demonstrating greater concern for the insurer's monetary interest than for the insured's financial risk. Where an insurer fails to meet the enhanced duty of good faith, the insurer may be obligated to indemnify the insured for any liability in the underlying action.

No Right to Independent Counsel

Alabama does not require an insurer to pay for independent counsel when the insurer defends under a reservation of rights. Instead, the aforementioned enhanced obligations of good faith apply.

Waiver and Estoppel

An insurer may waive a policy exclusion or condition if it fails to assert it, but coverage cannot be expanded by waiver. If an insurer accepts the defense of a case without issuing a reservation of rights to its insured, it may be estopped from subsequently disputing coverage.

Direct Actions Against Insurer

Injured persons do not have a right of action against the tortfeasor's insurer until the injured party has received a judgment against the insured.

Declaratory Judgement Actions

Declaratory Judgment Actions Favored

A declaratory judgment action is the most common method to adjudicate the rights of the parties to an insurance contract. A declaratory action is often used to determine whether or not an insurer has the duty to defend or if an insured violated a condition under the policy.

Necessary Parties

The tort claimant is an indispensable party to declaratory actions, either under federal or Alabama law. Otherwise, the coverage decision has no binding effect on the tort claimant, who may later file a direct action against the insurer.

Bad Faith Claims Against Insurers

First-Party Bad Faith

While Alabama recognizes first-party bad faith, a third party cannot bring a claim of bad faith.

Statute of Limitations

Coverage for the underlying claim is an absolute prerequisite to a claim for bad faith.

Elements of Proof

The elements of a bad faith refusal case are: (1) an insurance contract between the parties and a breach thereof by the defendant; (2) an intentional refusal to pay the insured's claim; (3) the absence of any reasonably legitimate or arguable reason for that refusal; (4) the insurer's actual knowledge of the absence of any legitimate or arguable reason; and (5) if the intentional failure to determine the existence of a lawful basis is relied upon, the plaintiff must prove the insurer's intentional failure to determine whether there is a legitimate or arguable reason to refuse to pay the claim.

Normal v. Abnormal Bad Faith

Bad faith cases separate into two categories: "normal" and "abnormal" bad faith cases. The plaintiff must prove the first four elements for a "normal" bad faith case; the fifth element only applies to the "abnormal" bad faith case.

Assignment of Bad Faith Claims

Alabama does not permit the assignment of bad faith actions.

Negligent or Bad Faith Failure to Settle

An insurer has a duty to act honestly and in good faith in its dealings with its insured. This duty of good faith encompasses a duty to use ordinary care and prudence in evaluating and acting upon settlement opportunities that arise in the context of lawsuits against the insured. If the insurer fails to exercise such reasonable or ordinary care, then it has breached its duty and is guilty of negligence. A decision not to settle must be a thoroughly honest, intelligent, and objective decision. It must also be a realistic one when tested by the necessarily assumed expertise of the insurance company.

Recoupment of Defense Costs

Although there is no Alabama law specifically addressing an insurer's recoupment of defense costs, the general rule is that where it is determined an insurer has no duty to defend, the insurer is not entitled to recoup from the insured for amounts spent in the defense of the insured unless the policy contains a specific provision allowing for recoupment.

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