Evolving Claim Duties in the U.S.—A Settlement Demand Is Not Always Necessary to an Insurer’s Duty to Settle

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A claim for bad faith failure to settle is a tort and, like all torts, requires a duty, breach of that duty and damages. Many insurers and claims handlers believe that the duty to settle does not arise until the third-party claimant makes an offer to settle within the policy limits.

Recent litigation in the U.S. has tested this long-held claim tenet, with the result that insurers in some states have a broader duty than previously thought. Several courts, faced with the issue of whether a demand is required, have held that it is not a prerequisite for the duty to settle. Indeed, they have gone so far as to impose an affirmative obligation on all insurers to initiate settlement.

This article discusses where and when a settlement demand is not always necessary to an insurer’s duty to settle. The trend adds to the many challenges facing Casualty Claim examiners in a difficult legal environment.

Latest Decision

Earlier this year, in Kelly v. State Farm Fire & Cas. Co., the Louisiana Supreme Court held that insurers must make a “reasonable effort to settle claims” on a case-by-case basis even in the absence of a firm settlement demand. This duty is based on Louisiana statute 22:1973(A), which provides that insurers have an “affirmative duty to...make a reasonable effort to settle claims with the insured or the claimant.”

The court held that a firm settlement demand is not a prerequisite to a bad faith claim because:

> The duty to settle can also be triggered by an insurer’s “knowledge of the particular situation.”
The insurer has an affirmative duty to gather this knowledge during the claims process. Duty to settle requires a case-by-case analysis of the insurer’s investigation and knowledge at the time of that investigation.

Louisiana now fits within the minority group of states following the rule that an insurer’s duty to settle is based on its control of defense and settlement. A few earlier decisions from other states had also found a duty to settle in the absence of a demand, but they were not state supreme court decisions. To see how the Louisiana decision fits in the national picture, we review the various approaches courts have taken when deciding when that duty to settle arises.

**When Settlement Duty Arises**

As with just about any insurance issue, courts across the country have adopted varying views on whether a settlement demand is a prerequisite to a duty to settle. Four distinct views have emerged over the years.

**Firm Demand to Settle Within Policy Limits**

Some jurisdictions have kept to a bright line rule that the duty to settle does not arise until the claimant or insured has first made a settlement demand within the policy limits. This rule encourages early settlements by requiring the claimant to make a settlement demand. As stated by the Texas court, a bright line rule requiring a settlement offer to give rise to a duty to settle is also based on a concern that a contrary rule would “discourage early dispute resolution by effectively requiring the insurer to bid against itself.” This rule also recognizes that “[i]t is an extraordinary thing to require an insurer to pay more than the policy limits.”

A settlement demand from the claimant serves as a useful warning to insurers that they may be liable for more than the policy limits.

In addition, excess insurers, whose duties are different from those of a primary insurer, may not have any duty to affirmatively initiate settlement negotiations. In a very recent case *SRM v Great Am Ins. Co.*, the 10th Circuit held that—because the duties of an excess insurer did not include the duty to “investigate, initiate settlement negotiations, or proactively tender its policy limits in the face of an unambiguous policy to the contrary and absent any settlement demand from the plaintiffs or proposed settlement agreement from the primary insurer”—the standard to initiate settlement discussions did not apply.

**Reasonable Opportunity to Settle Within the Policy Limits**

Some courts have taken a softer approach, holding that a firm settlement offer is not required to give rise to the duty to settle, but that such a duty will be triggered when the insurer has a reasonable opportunity to settle within the policy limits. In *Reid v. Mercury Insurance Co.*, a California appellate court held that an insurer can be liable for bad faith failure to settle in the absence of a demand or settlement offer from the third-party claimant when it has a reasonable opportunity to settle within the policy limits.

The insurer issued the insured an automobile policy with $100/300 bodily injury limits. The insured then failed to stop at a red light and caused a multivehicle collision. Six weeks after the accident, a claims manager for the insurer determined a policy tender was appropriate “as soon as we have enough [information] available to do so.” The insurer issued an excess letter to the insured. No settlement demand was made by the claimant. Several months after the insurer received medical records indicating that the claimant’s injuries were serious, it offered the policy limits. The claimant rejected the offer and won a judgment of $5.9 million against the insured.

The appellate court held that bad faith liability for failure to pursue settlement discussions requires, at a minimum, “some evidence either that the injured party has communicated to the insurer an interest in settlement, or some other circumstances demonstrating the insurer knew that settlement within policy limits could feasibly be negotiated. In the absence of such evidence, or evidence the insurer by its conduct has actively foreclosed the possibility of settlement, there is no ‘opportunity to settle’ that an insurer may be taxed with ignoring.”

According to the court, a conflict of interest requiring the insurer to effectuate settlement does not arise.
until the claimant has made an offer to settle a claim within the policy limits or when an insurer, faced with clear liability and a likely excess verdict, ignores an opportunity to settle.

The “opportunity to settle,” however, does not arise simply because there is a significant risk of an excess judgment. Because there was no evidence that the claimant at any time conveyed interest in settlement before the insurer offered its policy limits, there could be no bad faith failure to settle.

**Liability Is Clear and Likelihood of Damages Exceeds the Policy Limits**

In cases where liability is clear and the injuries are so serious that a judgment in excess of the policy limits is likely, many courts recognize that the insurer has an affirmative duty to initiate and effectuate settlement. In *Fulton v. Woodford*, the Arizona Supreme Court explained that such a rule is required because a conflict of interest between the insurer and its insured arises when there is a high potential of claimant recovery and a high potential of damages exceeding policy limits, requiring the insurer to take affirmative steps to protect the insured.

In *City of Hobbs v. Hartford Fire Ins. Co.*, the court held that summary judgment in favor of the insurer on the plaintiff’s bad faith failure to settle claim was not proper: Although the third-party claimant did not issue a settlement demand, the insurer knew that it had difficulties in the defense of the underlying case, was on notice that damages could exceed the policy limits, and did not make serious efforts to settle the case or engage in settlement discussions.

Several decisions apply this rationale to claim scenarios. In *Kropilak v. 21st Century Security Insurance Co.*, the insurer issued the insured an automobile policy with bodily injury limits of $10,000 per person and $20,000 per accident. The insured was involved in a serious automobile accident and the police report indicated that the insured was completely at fault. The day the insurance claim was reported to the insurer, a claims manager noted that serious injuries were probable and that an “excess letter” needed to be sent to the insured. Two weeks after

the incident, the insurer learned that the injured claimant’s medical bills totaled $33,880 and that his injuries were “incapacitating.” One month after the incident, and before the claimant made contact with the insurer, the insurer tendered the $10,000 policy limit. The claimant rejected the policy limits offer, filed suit and secured a judgment against the insured for $160,000. The insurer argued that no reasonable jury could conclude that it acted in bad faith because it tendered the policy limits 37 days after the accident without a demand and because it had no realistic opportunity to settle.

The district court disagreed, finding that a jury could conclude that the insurer knew that judgment in excess of the policy limits was likely and injuries were so serious that, therefore, it had an affirmative duty to initiate settlement negotiations. The court also held that the insurer’s failure to tender the policy limits until 37 days after the accident, and its failure to negotiate a settlement in excess of the policy limits, were material issues of fact, and whether they were reasonable was to be resolved by the jury.

In another case, *Cox v. Continental Cas. Co.*, the plaintiffs brought a bad faith claim against the insurer relating to its handling of hundreds of dental malpractice claims against the insured. The bad faith claims were based on the insurer’s settling of the individual claims sequentially rather than pursuing a global settlement of all claims against the insured. According to the complaint, the insurer ignored a letter from counsel for 198 of the claimants, suggesting that the insurer tender the policy limits. Several years later, the insurer attempted to negotiate a global settlement with the remaining claimants. After rejecting the proposed global settlement, the remaining claimants secured a $35 million arbitration judgment against the insured.
The insurer moved to dismiss the bad faith claim, arguing that the plaintiffs failed to allege the existence of an opportunity to settle the claims on a global basis because they did not allege the existence of a firm settlement demand. In denying the insurer’s motion to dismiss, the district court recognized that “Washington courts have not yet given a clear answer to the question of whether an insurer has an affirmative duty to initiate settlement negotiations in the absence of a within-limits offer by claimants.” However, the court found language approved by the Washington Supreme Court that implied an offer to settle by the claimant is not a necessary prerequisite for the good-faith duty to settle to arise. Accordingly, the court denied the insurer’s motion to dismiss and found, accepting the plaintiffs’ allegations as true, that they had plausibly alleged that the insurer acted in bad faith by disregarding a significant risk of judgment exceeding the policy limits when it ignored the letter proposing settlement discussions and instead pursued a strategy of settling each claim individually.

Some courts, notably from Illinois, have warned against applying this theory of bad faith failure to settle too broadly. In Adduci v. Vigilant Insurance Co., the insured argued that the insurer breached its duty to settle by failing to initiate settlement negotiations.11 The court disagreed, holding that “It is settled in Illinois that insurance companies are not required to initiate negotiations to settle a case” because “the imposition of such a requirement would put the insurer into a negotiating disadvantage which is imposed on no other litigant.” The court noted, however, that there is an exception “where the probability of an adverse finding on liability is considerable and the amount of probable damages would greatly exceed the insured’s coverage,” but stated that “we believe that this exception should be sparingly used, and then only in the most glaring cases of an insured’s liability, since trial attorneys are not endowed with the gift of prophecy so as to be able to predict the precise outcome of personal injury litigation.” In subsequent Illinois cases, the courts have confirmed that the insurer was not obligated to place a dollar figure on the negotiating table or make a large offer prior to trial.

**Control of Defense and Settlement**

In our last group are courts that suggest that where the insurer controls the defense and settlement of the third-party claim, it has an affirmative duty to investigate, evaluate and offer to settle claims when warranted.12 This is the foundation for the Louisiana decision.

In Rova Farms Resort, Inc. v. Investors Insurance Co. of America, the insured operated a resort that included a lake used by its guests for diving and bathing.13 The claimant, a guest of the resort, dove from a diving platform into the lake and suffered severe physical injuries. Although the insurer knew that an adverse verdict would likely exceed the $50,000 policy limit, serious issues of liability and the claimant’s contributory negligence existed. The claimant did not make a firm settlement demand before trial. The insured was ultimately hit with an excess verdict and brought a bad faith failure to settle claim against the insurer. The insurer argued that because no demand was made, there was no conflict of interest between the insurer and the insured and, therefore, it could not be liable for bad faith failure to settle within the policy limits.

The court rejected this argument as an “unduly constricted view of the law.” According to the court, a conflict of interest arose between the insurer and the insured the moment the insurer realized the gravity of the claimant’s injuries. Under those circumstances, “The better view is that the insurer has an affirmative duty to explore settlement possibilities.” The court held that the attitude of waiting for a settlement demand before engaging in settlement negotiations was “discordant with the requirement that the company in its fiduciary role [is] bound to consider itself potentially liable for the entire amount of any judgment.”

Some courts, holding that an insurer has a general duty to effect a settlement within the policy limits, apply certain factors to determine whether the insurer’s failure to settle was done in bad faith. In State Automobile Insurance Co. of Columbus, Ohio v. Rowland, the court held that the absence of a demand from the third-party claimant to settle within the
policy limit is merely one factor to consider in light of the surrounding circumstance in determining whether the insured acted in bad faith.\textsuperscript{14}

Other factors for the insurer to consider include:

\begin{itemize}
  \item The strength of the claimant’s case on liability and damages
  \item Attempts by the insurer to induce the insured to contribute to settlement
  \item Failure by the insurer to properly investigate the claim to ascertain evidence against the insured
  \item The injurer’s rejection of the advice of its counsel or agent
  \item The insurer’s failure to inform the insured of settlement offers
  \item The amount of financial risk each party is exposed to in refusing to settle
  \item The fault of the insured in inducing the insurer’s rejection of the settlement by misleading it as to the facts
\end{itemize}

The court recognized that an insurer does not act in bad faith by refusing to negotiate based on an honest belief that the insured’s act was not the proximate cause of the accident and that liability would be avoided on that basis.

**Conclusion**

An insurer should not presume that in all cases it will be insulated from excess of policy limits exposure where no settlement demand within policy limits has been made by the third-party claimant. As the cases mentioned here demonstrate, and the Louisiana decision reinforces, when an insurer possesses information indicating that a judgment in excess of policy limits is likely, the insurer should consider initiating settlement discussions with the third-party claimant in order to protect itself from later liability for an excess verdict.

It is worth noting that bad faith failure to settle cases only arises after an excess verdict has been entered against the insured. This fact alone makes it appear—to the trier of fact in the later failure to settle a case—that the insurer should have attempted to settle within the policy limits before the resulting excess judgment. However, the true question in any failure to settle claim is whether the insurer’s conduct was reasonable at the time.
About the Author

Steven D. Pearson is a member in the Chicago office of Cozen O’Connor, a national law firm with well-recognized practices in insurance, business law, litigation and government relations. Steve’s practice emphasizes the areas of insurance coverage, bad faith, reinsurance, professional liability and complex general commercial litigation. He has represented insurers at every stage of the process, from claims handling through trial and appeal in state and federal courts across the country. Steve has also served as national and regional counsel for a number of insurance companies in general liability, construction defect, municipal liability, health care, environmental, mass tort and bad faith claims. He has diverse jury and bench trial experience in both criminal and complex civil cases.

Steve has been engaged as an expert on insurance-related topics and speaks regularly at insurance coverage seminars throughout the country. He has also taught insurance law as an adjunct professor of law and has published articles in this area.

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We send our sincere thanks to Steve and Cozen O’Connor for contributing to Gen Re client research and publications.
Understanding jurisdictional differences is essential to reducing bad faith exposures. One global rule or claim standard does not work. The laws and regulations vary, along with the claim environment, and can change quickly. In this article, Cozen O’Connor provides powerful examples. The court in *Kelly* created an affirmative duty to act in the absence of an actual demand, and now all insurers in the state have a new standard. Insurers unaware of the ruling or its significance risk future bad faith claims.

The unique claim environment is just as important as the legal standards. We see dramatically different claim environments across the states, as evidenced by the divergent number and size of bad faith verdicts and settlements. A handful of jurisdictions generate the lion’s share of loss activity.

All insurers face the threat of bad faith, but the most vulnerable are those who have little experience in a volatile state. The more seasoned carrier is aware of the minefields and may already work with local counsel to avoid them. For the new entrant, it’s important to get the lay of land before handling a claim. Even a single misstep can be costly in some states.

Gen Re’s claim executives often work with clients to share observations about difficult jurisdictions as well as resources to prevent or respond to bad faith actions. We concur with the best practices discussed in this article and want to remind Gen Re clients about our Jurisdictional Law Survey on Bad Faith to highlight jurisdictional rules and differences.

As a reinsurer, we have a window into the local claim environment from working with single-state, regional and national carriers. Similarly, Cozen O’Connor attorneys represent insurers in all states.

If we can share our knowledge or perspective, please do not hesitate to ask anyone in Gen Re’s Claim Department. We welcome the discussion, as do the attorneys at Cozen O’Connor.

Ask your Gen Re representative for a copy of the *Bad Faith Laws for Property/Casualty Claims Law Survey*. It’s on genre.com with an ID and password.