

## **Bad Faith Claims When Verdicts Exceed Policy Limits: Nuances of the Insurance Company's Duty to Settle**

Reducing Company Exposure; Options for Policyholders When Company Rejects Settlement Demand

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THURSDAY, FEBRUARY 4, 2021

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Today's faculty features:

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# Bad Faith Claims When Verdicts Exceed Policy Limits: Nuances of the Insurer's Duty to Settle

Reducing Insurance Company Exposure; Options for Policyholders  
When Insurer Rejects Settlement Demand

Thursday, February 4, 2021

1:00pm-2:30pm EST, 10:00am-11:30am PST

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# I. SCOPE OF INSURER'S DUTY TO DEFEND AND DUTY TO SETTLE

## Insurer Duties

- Insurers have two important duties
  - Duty to defend
  - Duty to indemnify
- Insurers also have a duty to act reasonably with respect to settlement
- This duty is critically important
  - For insurers and policyholders
  - For courts and third-party claimants
- Yet the duty is problematic in several ways
  - Not expressly stated in most insurance policies
  - Scope and nature are poorly understood
  - Case law is murky, inconsistent and varies by jurisdiction

# DUTY TO DEFEND - CONTROL OF SETTLEMENT

- Defending insurer controls settlement
  - Policy language: Insurer may “at [its] discretion . . . settle any claim or suit”
  - Can enforce unless insurer has denied coverage or otherwise breached policy obligations
  - Defending insurer controls settlement even where insurer reserved rights
- Non-defending insurer does not control settlement
  - Policyholder can reasonably settle claims without insurer consent

# DUTY TO DEFEND - CONTROL OF SETTLEMENT (CONT'D)

- Insurer may choose to settle over policyholder's objection unless the policy explicitly requires the insured's consent
- In many states, insurer can reserve rights and file suit against policyholder for reimbursement of settlement amount
  - *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313 (Cal. 2001) (“We conclude an insurer may be reimbursed for a reasonable settlement payment made over the objection of its insureds.”)
- But not in all states
  - *Utica Mut. Ins. Co. v. Rohm and Haas Co.*, 683 F. Supp. 2d 368 (E.D. Pa. 2010) (under Pennsylvania and Illinois law, insurer not entitled to reimbursement of settlement amount absent policy provision providing for reimbursement)

# DUTY TO DEFEND - CONTROL OF SETTLEMENT (CONT'D)

- Does policyholder have to seek insurer consent for a settlement?
- Consent requirement may appear in various policy provisions
  - Definitions (e.g., “Loss”)
  - Cooperation/Defense/Voluntary Payments clause
    - “No Insured will, except at that Insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense . . . without our consent.”
  - No Action/Loss Payable clauses
    - “No action shall lie against the [insurer] unless . . . the insured’s obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the [insurer].”

# DUTY TO DEFEND - CONTROL OF SETTLEMENT (CONT'D)

- Failure to seek consent may violate the policy and forfeit coverage
  - Even without prejudice in certain jurisdictions (*See Vigilant Ins. Co. v. The Bear Stearns Cos.*, 10 N.Y. 3d 170 (2008))
- *Babcock & Wilcox Co. v. American Nuclear Insurers*, 131 A.3d 445 (Pa. 2015)
  - Insurer defending under reservation of rights
  - Policyholder accepted reasonable and non-collusive settlement offer, without insurer's consent
  - Insurer found liable for breach of contract
  - Damages were amount paid to settle covered claims
  - Policyholder did not have to show bad faith

# DUTY TO SETTLE - SOURCE

- Insurer's discretion regarding settlement decisions is constrained by its duties to policyholders
- Sources of the duty to settle include:
  - Duty not to unreasonably withhold (or delay) consent to settlement;
  - Duty to defend; and
  - Covenant of good faith and fair dealing (bad faith).

# DUTY TO SETTLE - SCOPE

- Insurer must assess settlement offers and respond to them promptly, fairly and in good faith
- Must evaluate claims on their merits
- If a settlement offer is reasonable, insurer has duty to accept it
- In some jurisdictions, insurer has an affirmative duty to effect a settlement once liability becomes reasonably clear

# DUTY TO SETTLE – SCOPE (CONT'D)

- How do you assess reasonableness?
  - Is it likely that trial will result in an award of damages greater than the settlement offer?

**[likelihood of adverse judgment] x [likely damages] > offer ?**

- Are non-covered claims included in the analysis?
- Are punitive damages considered?
- If reasonable, is there a presumption of insured's liability for coverage purposes? (*See Isaacson v. California Ins. Guar. Ass'n*, 44 Cal. 3d 775 (1988))

# DUTY TO SETTLE – MULTIPLE INSURERS

- Settlement by multiple insurers
  - Where multiple insurers cover a claim, and a reasonable settlement amount is received for an amount greater than the limits of any one policy, but less than all available limits, each insurer has obligation to accept settlement up to its policy limits
    - *Howard v. Am. Nat'l Fire Ins. Co.*, 115 Cal. Rptr. 3d 42 (Cal. App. 2010)

# DUTY TO SETTLE – MULTIPLE INSUREDS (CONT'D)

- Where claims are asserted against multiple insureds, most jurisdictions allow insurers to enter piecemeal settlements that are reasonable and reflect relative liability of insureds
- Insurers cannot prefer the interests of one insured over interests of other insureds
- Some jurisdictions do not allow piecemeal settlements
- Insurer can interplead policy limits to “wipe their hands clean”

# DUTY TO SETTLE – RECOUPMENT

- In many jurisdictions, insurer is allowed to settle with claimants subject to its right to recover amount from policyholder
- Prerequisites to obtaining reimbursement:
  - Timely and expressly reserve the right to recoup
  - Notify the policyholder of the insurer's intent to accept a settlement
  - Give the policyholder the option to assume the defense (at its own expense)
    - *See, e.g., Travelers Prop. & Cas. Co. of Am. v. Hillerich & Bradsby Co., Inc.*, 598 F.3d 257 (6th Cir. 2010); *Blue Ridge Ins. Co. v. Jacobsen*, 22 P.3d 313 (Cal. 2001)

## II. INSURER'S RISK OF CLAIMS FOR BAD FAITH LITIGATION

### Insurer's Exposure to Bad Faith Liability

- When insurer breaches duty to settle, policyholder may pursue tort claims for breach of covenant of good faith and fair dealing – *i.e.*, bad faith
- Standards for imposing liability
- Damages may include extra-contractual/consequential damages.
  - Full amount of any judgment in excess of policy limits
  - Other consequential damages proximately caused by insurer's breach
  - Emotional distress
  - Attorneys' fees incurred to establish coverage (*Brandt v. Superior Court*, 693 P.2d 796 (Cal. 1985))
  - In cases of serious misconduct, punitive damages

# INSURER'S EXPOSURE TO BAD FAITH LIABILITY

- Factors courts consider on bad faith claims
  - Insured's probable liability and range of possible damages
  - Advice of defense counsel and claims adjuster
  - Whether insurer adequately investigated the claim and the insured's potential liability
  - Whether insurer had sufficient information to evaluate the settlement
  - Insurer's willingness to engage in settlement negotiations
  - Whether insured kept insurer informed of negotiations
  - Whether insured demonstrated reasonableness and sought consent for offers
  - Evidence that insurer placed its financial interests ahead of those of the policyholder

### III. BEST PRACTICES FOR INSURERS TO REDUCE EXPOSURE TO BAD FAITH LITIGATION, INCLUDING THE BAD FAITH SET UP



“It seems to me that [some] attorneys who handle policy claims against insurance companies are no longer interested in collecting on those claims, but spend their wits and energies trying to maneuver the insurers into committing acts which the insured can later trot out as bad faith.”

*White v. W. Title Ins. Co.*, 710 P.2d 309, 328 n.2 (Cal. 1985) (Kaus, J. concurring and dissenting)



# OVERVIEW - STANDARD OF CARE

"the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business."

"in good-faith and with due regard for the interests of the insured."

*Boston Old Colony – Florida Supreme Court 1980*



1. Thoroughly investigate the cause of the insured's accident and the nature and severity of the plaintiff's injuries,
2. Retain competent defense counsel, recognizing that only the insured is the client, and
3. Fully inform the insured not only of the reservation of rights defense itself, but of all developments relevant to her policy coverage and the progress of the lawsuit.

*Ki Sin Kim V. Allstate Ins. Co.*, 223 P.3d 1180, 1192 (Wash. Ct. App. 2009)

# PRE-LITIGATION: SPOTTING THE RED FLAGS

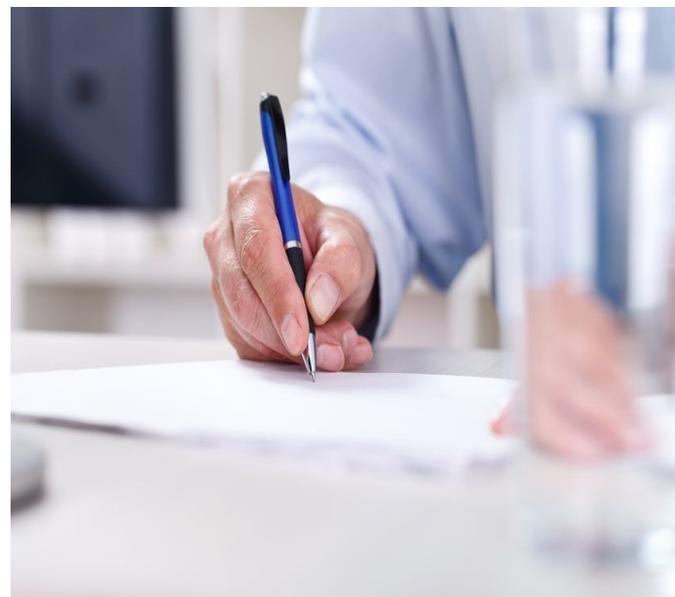


# APPROPRIATE RESPONSE TO RED FLAGS

Communication



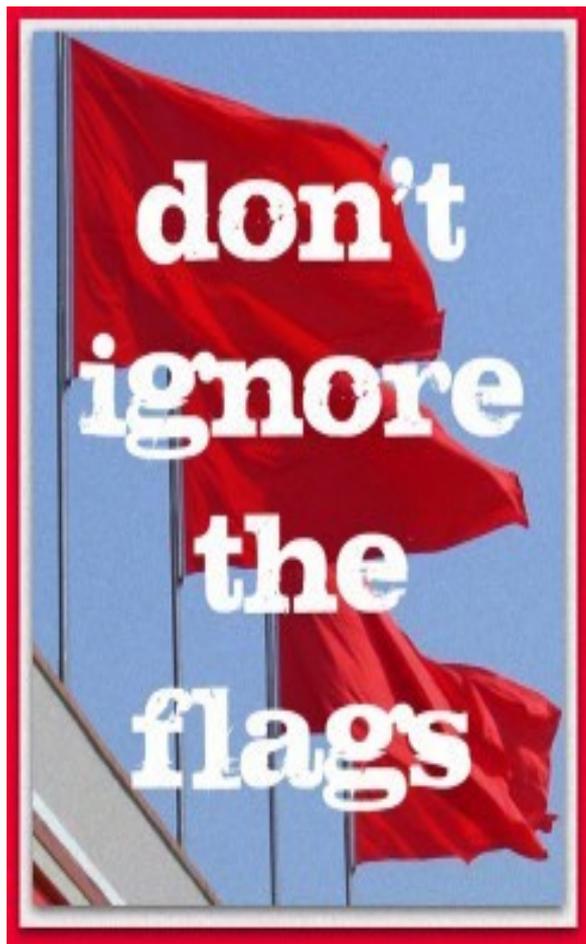
Documentation





# *Put it in writing*





# The Top 10 Bad Faith Traps



# 1. Plaintiff's Demand sets SHORT TIME LIMIT

# RESPONSE?

- Immediately respond in writing.
- **Ask for an extension and explain why** the extension is necessary.
- Ask if there are any reasons for the deadline.
- Try to get commitment as to why compliance and tender in 21 days will not be acceptable, but 20 days would be.
- If the time limit has expired, say why the response is not timely.



## 2. Plaintiff makes a UNILATERAL Contract Offer

# RESPONSE?

- Attempt to **comply** with all demands.
- **Document** all efforts to comply.
- Keep insured/policyholder **advised of all settlement offers.**



3. Plaintiff's Demand  
requires tender of limits  
IN HAND

# RESPONSE?

- **Request clarification by letter or email** to claimant's counsel explaining how the conditions are vague.



4. Plaintiff's Demand  
requires FULL COMPLIANCE with insurance  
disclosure statute or to provide a financial  
affidavit

# RESPONSE?

- Review your state's insurance disclosure requirements.
- Confirm that you have met each statutory requirement.
- Make every effort to comply with financial affidavits requested. Hire counsel for insured if necessary.



5. Plaintiff's Counsel says:  
"You can trust us to resolve any liens."

# RESPONSE?

- Confirm in writing that Plaintiff agrees to satisfy any liens and indemnify defendant.



6. Plaintiff conditions settlement on a SIMPLE release with NO OVERREACHING TERMS

# RESPONSE?

- Ask for clarification as to what “overreaching terms” means.
- Ask claimant’s counsel to confirm proposed release is acceptable and if it is not, to advise of deficiencies.
- When tendering limits, advise claimant’s counsel that proposed release is not a counteroffer and that carrier is open to edits.



## 7. Plaintiff's attorney's UNAVAILABILITY

# RESPONSE?

- **Document the claim file**, noting every single attempt to contact claimant's attorney.
- Detail all of your efforts to reach the claimant or her attorney in a **letter** to her and to her counsel.



## 8. NO DEMAND

# RESPONSE?

- **Do not delay** investigation and settlement negotiations.
- **Initiate** settlement discussions.
- A delay in settlement negotiations can give rise to bad faith where the delay is willful and without reasonable cause.
- Where excess judgment is likely, insured must be advised and given opportunity to contribute to settlement.



9. Demand is peppered with  
SELF-SERVING RHETORIC

# RESPONSE?

- Respond **immediately** – letter, call, email.
- Keep accurate and detailed records of your actions to investigate and settle the claim.
- Keep insured aware of claim.



## 10. Repeated Demands for Explanation

# RESPONSE?

- Must think that **every letter will be blown up at trial.**
- Especially in medical malpractice and construction claims, **consult expert.**



## IV. OPTIONS FOR POLICYHOLDERS WHEN THE INSURER DOES NOT WANT TO SETTLE



Provide notice to all excess insurance companies that might be reached by a judgment excess of the limits of the primary insurance policy.



Encourage the excess insurance companies to communicate with the primary insurance company.



You want to get the assistance of the excess insurance companies to come to your aid with the primary insurance company.



Get a written recommendation by the underlying defense counsel to accept a settlement within limits and send it to the insurance company.



Make clear in writing to the primary insurance company that you recommend settling within limits

-AND-

That you will seek bad faith damages against the primary insurance company to the extent there is a judgment in excess of policy limits.

If the primary insurance company won't settle, ask the excess insurance company to pay the settlement.

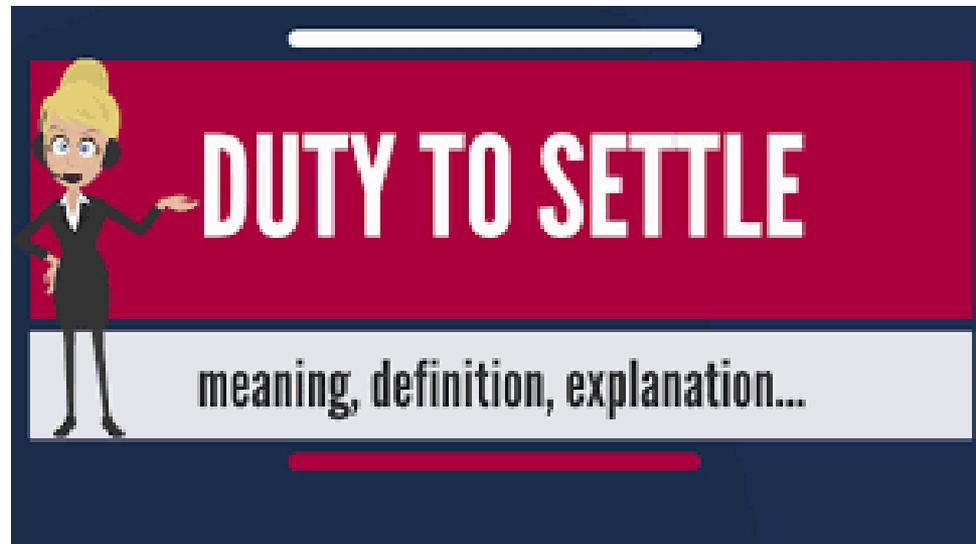
- You may have to offer the excess insurance company your rights to go against the primary insurance company.
- The excess insurance company may do this if it believes that its exposure would be lessened.



If all else fails, policyholder pays and then sues for Bad Faith.



## V. POLICYHOLDER REMEDIES WHEN THE INSURANCE COMPANY BREACHES ITS DUTY TO SETTLE



# BAD FAITH

When confronted with a claim that exceeds its limits, a primary insurance company may litigate the claim because the primary insurance company has little or nothing to lose and then is “gambling with either the excess insurance company’s money or the policyholder’s money, or both.”

Gary M. Bloom, *Recovery Against Primary Insurer By Excess Carrier For Bad Faith or Negligent Failure to Settle*, 36 Ins. Conns. J. 235, 237 (1969).

Potential Triangular Reciprocal Duty Between the Policyholder, the Primary Insurance Company and the Excess Insurance Company.

All three parties (policyholder, primary and excess insurance companies) might owe reciprocal duties to each other.

*Commercial Union Assur. Co. v. Safeway Stores, Inc.*, 610 P.2d 1038, 1043 (Cal. 1980) (However, the excess insurance company only might be able to look to the primary insurance company, not the policyholder).

# EXPOSURE OVER POLICY LIMITS

“[A]n insurer, who was found to have wrongfully denied coverage, and who failed to consider a settlement claim that would have been less than the policy amount, should be liable for a Judgment in excess of the policy amount.”

*Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198, 201 (Cal. 1958).

“[A] liability insurer, after taking control of settlement decisions for claims against its insured, may become liable in excess of its undertaking, under the terms of the policy, if it fails to exercise ‘good faith’ in considering offers to settle the claim for an amount within the policy limits.”

*Noe v. American Fam. Mut. Ins.*, 2002 U.S. Dist. LEXIS 13450, 2002 W: 1634251 at \*3 (D. Minn., July 17, 2002).

# AFFIRMATIVE DUTY TO INITIATE SETTLEMENT DISCUSSIONS

“‘[I]f an insured’s liability is clear and the injuries of a claimant are so severe that a judgment in excess of policy limits is likely,’ a primary ‘insurer has an affirmative duty to initiate settlement negotiations.’”

*Badillo v. Mid Century Ins. Co.*, 2005 OK 48, 121 P.3d 1080, 1095 (Okla. June 21, 2005), as corrected, (June 22, 2005).



# PRIMARY INSURANCE COMPANY OBLIGATED TO NOTIFY EXCESS INSURANCE OF POTENTIAL EXCESS JUDGMENT

No contractual duty but duty arising from distinctive relationship between the two insurance companies.

*American Central Ins. Co. v. Warner-Lambert Co.*, 293 N.J. Super. 567 (1995); *Monarch Cortland v. Columbia Casualty Co.*, 626 N.Y.S.2d 426 (1995). (citing the “Guiding Principles for Insurers of Primary and Excess Coverage” enacted in 1974).

# EXCESS INSURANCE COMPANY OBLIGATED TO NOTIFY POLICYHOLDER AND PRIMARY INSURANCE COMPANY IF IT PERCEIVES DEFENSE TO BE INADEQUATE

Failure to so notice estops excess insurance company for  
objecting to defense afterward.

*Phico Ins. Co. v. Aetna Cas. & Sur. Co.*, 93 F.Supp. 2d 982 (S.D. Ind. 2000);  
*Liability Insurance: Excess Carrier's Right of Action Against Primary Carrier for  
Improper or Inadequate Defense of Claims*, 49 A.L.R. 4<sup>th</sup> 304 (1986).

# EXCESS INSURANCE COMPANY MUST RESPOND TO SETTLEMENT OFFERS WITH SAME GOOD FAITH AS REQUIRED OF PRIMARY INSURANCE COMPANIES

No active role in defense did not relieve excess insurance company of duty of good faith to policyholder.

*Kelly v. British Commercial Ins. Co.*, 221 Cal. App. 2d 554 (1963), Ashley, Bad Faith Actions: Liability and Damages, §6:21 (1984).

# WHEN THE POLICYHOLDER PAYS DEFENSE COSTS THAT THE PRIMARY INSURANCE COMPANY SHOULD HAVE PAID

“When a breach of the duty to defend occurs, the insured ‘is entitled to be reimbursed for attorney’s fees and costs expended’ to force the insurer to pay for the defense.”

*Indep. Sch. Dist. No. 697 v. St. Paul Fire & Marine Ins. Co.*, 515 N.W.2d 576, 581 (Minn. 1994).



# EXCESS JUDGMENT MAY NOT BE REQUIRED

No excess judgment was required if the primary insurance company's alleged bad faith failure to defend exposed the policyholder to excess liability and caused the excess settlement.

*RSUI Indemn. Co. v. Am. States Ins. Co.*, 768 F3d 374 (5<sup>th</sup> Cir. 2014); *But see*, *RLI Ins. Co. v. CNA*, 141 Cal. App. 4<sup>th</sup> 75 (2006).



# WHEN THE EXCESS INSURANCE COMPANY PAYS DEFENSE COSTS THAT THE PRIMARY INSURANCE COMPANY SHOULD HAVE PAID

A primary insurance company can be held liable to an excess insurance company for the cost of defending a lawsuit when the primary insurance company wrongfully refuses to defend.

*Western Pacific Ins. Co. v. Farmers Ins. Exchange*, 416 P.2d. 468 (Wash. 1966).

## AND IT CAN WORK THE OTHER WAY

“[P]rimary insurer could maintain equitable subrogation claim against excess insurer for unwarranted costs when primary insurer was forced to continue to defend insured because excess insurer rejected reasonable, within-limits settlement offers.”

*Am. Alt. Ins. Corp. v. Hudson Specialty Ins. Co.*, 938 F. Supp. 2d 908, 917 (C.D. Cal. 2013).



“[E]xcess insurer might be liable for portion of settlement that exceeded primary limits but was within excess limits when excess insurer rejected within-excess-limits settlement demand.”

*Diamond Heights Homeowners Assn. v. Nat’l. Am. Ins. Co.*, 227 Cal. App. 3d 563, 277 Cal. Rptr. 906, 916 (Ct. App. 1991).

“[E]xcess insurer may be liable for insured’s out-of-pocket payment to settle case when excess insurer refused reasonable within-limits settlement offers.”

*N. Am. Van Lines, Inc. v. Lexington Ins. Co.*, 678 So. 2d 1325, 1333-34 (Fla. Dist. Ct. App. 1996).



“These duties may require an excess insurer to consider various factors, including the maximum likely recovery at trial, costs of defense, and the burdens of trial *‘in evaluating the reasonableness of a settlement negotiated by the primary insurer.’*”

*Diamond Heights Homeowners Assn. v. Nat’l. Am. Ins. Co.*, 277 Cal. Rptr. 906, 916 (Ct. App. 1991).

# DUTY TO APPEAL

An excess insurance company is entitled to reimbursement for discharging the primary insurance company's duty to appeal.

*Fidelity Gen. Ins. Co. v. Aetna Ins. Co.*, 278 N.Y.S. 2d 787 (App. Div. 1967).



