Settlement Traps 2019: Can You Wait? Or Must You Initiate?

Critical Recent Developments in Time Limit Demands, Tenders & Other Bad Faith Set-Ups

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That liability insurers owe a duty of good faith and fair dealing to their insureds and can be held liable for bad faith for failing to act with due care toward the rights and interests of their insureds is a well-worn axiom in our industry. Furthermore, it is well-accepted that an insurer's failure to accept a reasonable settlement demand within policy limits lies among the myriad grounds an insured may claim extra-contractual liability against an insurer. *But, can an insurer have extra-contractual liability even if it never receives a demand from the claimant? Can extra-contractual liability exist even where the insurer was not presented with an affirmative opportunity to accept a settlement?*

Each state treats this issue differently, but the answer in a growing number of states over the last decade is "yes." And the circumstances under which an insurer can be held to pay an excess judgment for failing to offer its limits seem to be multiplying, particularly in states like Florida.

This paper discusses the three main approaches states take to this issue. Rather than simply summarize these positions, we attempt here to identify some of the subtle differences among these approaches, even within the three categories. More importantly, we present some ideas as to how insurers can protect themselves under the various regimes.

<u>Approach #1: Wait till They Come to You</u>

The least restrictive approach holds that an insurer does not bear extra-contractual liability unless a settlement demand within limits is presented to the insurer. Insurers under this regime have the luxury of not having to affirmatively make offers until there is a definitive demand.

Very recently, the Georgia Supreme Court, in a widely publicized ruling (and against the expectations of many considering the recent rulings in neighboring Florida[1]), definitively placed Georgia in this category. In *First Acceptance Ins. Co. of Ga. v. Hughes,* 826 S.E. 2d 71 (March 11, 2019), the Georgia Supreme Court held that the insurer did not act unreasonably in failing to accept the injured parties' offer within limits, because that offer, which did not contain an acceptance deadline, was abruptly withdrawn without notice prior to a scheduled settlement conference that those parties had committed to attend. In those circumstances, the absence of a

[1] Reference is made to *Harvey v. GEICO Gen. Ins. Co.*, 259 So. 3d 1, 7 (Fla. 2018), discussed below.

deadline for accepting the offer was a critical fact. In that case, the insured caused a multi-vehicle collision. The insured perished in the crash, and his auto insurer was advised that five other people had been injured as a result of the collision and retained counsel to help resolve the five known injury claims. The insurer's counsel sent a letter to the attorneys for the claimants to inform them of the insurer's interest in arranging a joint settlement conference/mediation in an effort to resolve the claims. Counsel for two of the claimants sent letters to the insurer's counsel stating his clients' interest in attending a settlement conference, and, in the alternative, offering to settle for the available policy limits. The claimants' counsel later filed a complaint against the administrator of the insured's estate seeking damages arising out of the collision and, shortly thereafter, revoked the offer. The jury returned a verdict against the administrator, which sued the insurer alleging negligence and bad faith in the insurer's failure to settle within policy limits. The appellate court reversed the trial court's grant of summary judgment to the insurer on the administrator's failure-to-settle claim.

The Georgia Supreme Court granted *certiorari*. The Georgia Supreme Court reversed, finding that the offer did not include a deadline for acceptance and that the insurer was not put on notice that its failure to accept the offer within any specific period would constitute a refusal of the offer, nor could it have reasonably known that it needed to respond promptly or risk that its insured would be subject to a judgment in excess of policy limits. The Supreme Court found that the insurer's failure to promptly accept the offer was reasonable, as an ordinarily prudent insurer could not be expected to anticipate that the claimants would abruptly withdraw their offer.

Based on a similar rational applied by the Georgia Supreme Court, the U.S. Fifth Circuit in *Hemphill v. State Farm Mut. Auto Ins. Co.*[2] has suggested that Mississippi would impose no affirmative duty to initiate settlement onto an insurer. That court stated:

> [N]o case from either the Mississippi Supreme Court. or a Mississippi intermediate appellate court, has suggested or even hinted that the Mississippi Supreme Court would hold that an insurer has a duty to make a settlement offer, absent a settlement offer by the claimant.[3]

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[2] 805 F.3d 535

[3] *Ibid*., at 540.

As such, the court ruled that Mississippi "would not impose such duty" without some settlement communication by the plaintiff because "there is no such duty to settle under Mississippi law."[4]

In Illinois, the courts have also given qualified permission for insurers to wait for a demand but they have done so with language that is less categoric than in Mississippi: "Ordinarily, an insurer owes no duty to make an offer to settle a case which it is defending."[5] However, similar to Florida's *Powell* claims,[6] 1) when liability is great and 2) probable damages likely exceed coverage, the insurer may owe a duty to initiate settlement negotiations.[7] Unlike the states that require insurers to initiate settlement under these circumstances, Illinois "believe[s] that this [obligation] *should be sparingly used…only in the most glaring cases*[8] *of an insured's liability*."[9]

Following *American Physicians Insurance Exchange v. Garcia*,[10] Texas finds that if the insured does not demand that the insurer settle within policy limits, or, if no offer to settle within the policy limits is presented by the claimant, the insurer cannot be liable for bad faith in its failure to initiate settlement negotiations. An insurer may not be sued for a bad faith failure to settle "until the claimant has presented the insurer with a proper settlement demand within policy limits that an ordinary prudent insurer would have accepted."[11] This ruling has been consistently cited by Texas courts and has been applied as recently as 2017.[12]

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4 *Ibid*.

5 *California Union Ins. Co. v. Liberty Mut. Ins. Co.*, 920 F. Supp. 908, 920 (1996) (citing *Adduci v. Vigilant Ins. Co.*, 98 Ill. App. 3d 472, 475 (1st Dist. 1981)).

6 Reference is made to *Powell v. Prudential Prop. & Cas. Co.* 584 So. 2d 12, 14 (Fla. 3d DCA 1991), discussed below.

7 *California Union*, supra., n. 5, 920 F. Supp. 908 at 920.

8 "Trial attorneys are not endowed with the gift of prophecy so as to be able to predict the precise outcome of personal injury litigation." *Kavanaugh v. Interstate Fire & Casualty Co.*, 35 Ill. App. 3d 350, 356 (1975).

9 *Adduci*, 98 Ill. App. 3d 472 at 478 (emphasis added).

10 876 S.W. 2d 842, 865-66 (1994).

11 *Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co*., 77 S.W.3d 253, 262 (Tex. 2002).

12 *See Travelers Lloyds Ins. Co. v. Cruz Contr. Of Tex.*, 2017 U.S. Dist. LEXIS 215264.

California's stance is complicated, but currently appears to support the notion that insurers do not have an affirmative duty to initiate settlement. In the 2012 decision, *Du v. Allstate*,[13] the United States Court of Appeal for the Ninth Circuit held that "under California law, an insurer has a duty to effectuate settlement where liability is reasonably clear, even in the absence of a settlement demand." Following a successful motion for rehearing, the Ninth Circuit withdrew its analysis in *Du*, but chose not to renounce its analysis on whether insurers have a duty to initiate a settlement.[14] California courts do not view the *Du* holding as controlling precedent, but they have found it "highly persuasive."[15]

In contrast to the broadly construed *Du* opinion, the California Court of Appeals in *Reid v. Covert*[16] recently held that for bad faith to apply, "… there must be, at a minimum, some evidence either the injured party has communicated to the insurer an interest in settlement, or some other circumstance demonstrating the insurer knew that settlement within policy limits could feasibly be negotiated."

The *Reid* decision implies that an insurer's duty of good faith is broader than the duty to simply accept a settlement demand, but narrower than the *Du* holding which imposes an affirmative obligation to initiate settlement discussions. *Reid* does, however, make it clear that the California Insurance Code does not impose an affirmative duty to settle.[17] In summary, the law is not clear in California, but an insurer should never take any action (or inaction) that would appear to foreclose the possibility of settlement.[18]

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13 681 F. 3d 1118 (9th Cir. 2012

14 *Du v. Allstate*, 697 F.3d 753 (2012.

15 *Travelers Indem. Of Conn. v. Arch Specialty Ins. Co.*, 2013 U.S. Dist. LEXIS 169453, at *24 and *29-30 (Nov. 26, 2013) ("[U]nder California law, the duty of an insurer to effectuate settlement requires more than merely doing nothing while awaiting a formal settlement demand.")

16 220 Cal. App. 4th 262, 272 (2013).

17 *Ibid.* at 276.

18 *Ibid.* at 272.

Approach #2:

The Insurer Must, *Under Some Circumstances*, Initiate Settlement Discussions

Some states find that, only under some specific circumstances, an insurer must actually initiate settlement negotiations. These holdings are very specific to the states (and holdings) in questions.

Kansas has allowed bad faith claims against an insurer for failing to initiate a settlement, albeit in limited situations. In *Roberts v. Printup*,[19] the state circuit court found that "Kansas imposes, under certain circumstances, a duty upon an insurer to initiate settlement negotiations even without an offer to settle being made by the claimant." An insurer's affirmative duty to initiate settlements does not automatically occur upon knowledge of an injury. Rather, a Kansas insurer's duty to initiate settlement depends on "if the carrier would initiate settlement negotiations on its own behalf were its potential liability equal to that of its insured."[20] Thus, when there is a claim for damages in excess of the policy limits, a conflict of interest exists between the carrier and insured, and the duty to settle arises if the carrier would initiate settlement negotiations on its own behalf.[21]

Arizona mirrors the approach in Kansas and imposes an affirmative good faith duty upon insurers to initiate settlement when "a conflict of interest would give rise to a duty on behalf of the insurer to give equal consideration to the interest of its insured where there is a high potential of claimant recovery and a high probability that such a recover will exceed policy limits." [22]

This "conflict-of- interest-good-faith-settlement initiation analysis" has been applied as recently as 2019.[23]

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19 422 F. 3d 1211, 1215-16 (2005) (citing *Smith v. Blackwell*, 791 P. 2d 1343, 1346 (Kan. Ct. App. 1989)).

20 *Ibid.* (citing *Coleman v. Holecek*, 542 F. 2d 532, 537 (10th Cir. 1976).

21 *Coleman, supra*., n. 16.

22 *Fulton v. Woodford*, 545 P.2d 979 (1976).

23 *See Country Mut. Ins. Co. v. Martinez*, 2019 WL 1787313 (D. Ariz. Apr. 23, 2019).

In Washington, there have been rulings indirectly stating that an insurer has an affirmative duty to initiate settlement. For example, one district court stated as follows:[24]

> 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 same court found that "Washington does not consider a within-limits offer a requirement" for a bad faith claim, noting that "[l]anguage used or approved by the Washington Supreme Court also implies an offer by the claimants is not a necessary prerequisite."[25] While a degree of ambiguity is present for Washington's application of an insurer's good faith duty to initiate settlement, jurisprudence suggests that the duty does exist.[26]

Approach #3: Insurer Must Initiate

Florida is the most troubling when it comes to an insurer's affirmative obligation to initiate settlement discussions. In 1991, Florida's Third District Court of Appeal ruled in *Powell v. Prudential Prop. & Cas. Co* that, "[w]here liability is clear, and injuries so serious that a judgment in excess of the policy limits is likely, *an insurer has an affirmative duty to initiate settlement negotiations.*"[27] Florida courts have clearly and consistently found insurers liable for bad faith in dealing with "*Powell* claims" where insurers have failed to initiate settlement when 1) liability is clear, and 2) the judgment will likely be in excess of the policy limits.[28] The practical effect of this line of cases was that until 2018, insurers in Florida tendered policy limits (or the loss amount) to a claimant as soon as the insurer determined that liability and damages were clearly against the insured.

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24 *Cox v. Cont'l Cas. Co.*, 2014 U.S. Dist. LEXIS 68081, 8-9 (W.D. Wash. May 16, 2014).

25 *Ibid.*

26 *See, e.g., Moratti v. Farmers Ins. Co. of Wash.*, 254 P. 3d 939, 942 (2011) "An insurer owes its insured a duty to act in good faith, which *includes an affirmative duty to undertake a good faith effort to settle* when an insured's liability is likely." (emphasis added).

27 *Powell v. Prudential Prop. & Cas. Co.*, 584 So. 2d 12, 14 (Fla. 3d DCA 1991) (emphasis added).

28 *Ibid* and see *Aboy v. State Farm Mut. Auto Ins. Co.*, 394 Fed. Appx. 655, 656 (2010).

In *Bannon v. Geico Gen. Ins. Co*., an unpublished opinion rendered in June 2018, the United States Court of Appeal for the Eleventh Circuit further tightened the standard by upholding a finding of bad faith against Geico for failing to tender its limits *as soon as it had information that the insured was more than likely liable to the claimant,* who suffered catastrophic injuries.[29] There, the claimant was badly injured in an auto accident where Geico's driver failed to yield the right of way. Geico was aware of this when it received the police report of the accident on November 4, 2010. Geico also knew on that date that the claimant had suffered a brain injury. Although a question later arose of whether the claimant had the lights of her motorcycle on, the Eleventh Circuit upheld the finding that Geico should have tendered its $250,000 limits based on the information it had on November 4, 2010—not 18 days later (and four days after the insured told Geico that he met with an attorney).[30]

Under *Bannon*, insurers cannot wait to tender limits until a complete investigation is done. Rather, where damages are great, insurers should tender *as soon as there is any information supporting the insured's liability*.

Unfortunately, even meeting the *Bannon* standard does not appear sufficient to avoid bad faith in Florida, as insurers must also timely comply with a claimant's requests directed to the insured in addition to tendering limits. The Florida Supreme Court recently added an additional twist to insurers obligations in *Harvey v. GEICO Gen. Ins. Co.,*[31] effectively holding that an insurer's negligence can constitute bad faith. In that case, despite Geico's tendering policy limits nine days after the fatal motor-vehicle accident that gave rise to the claim against the insured, the Florida Supreme Court found that Geico acted in bad faith because Geico did not immediately provide the claimant with a statement from the insured on the extent of the insured's assets, as the claimant had requested.[32]

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29 *Bannon v. Geico Gen. Ins. Co.,* 743 F. App'x 311, *312 (11th Cir. 2018)

30 *Ibid.* at 313

31 259 So. 3d 1, 7 (Fla. 2018).

32 *Ibid.*

Although Geico immediately responded to the claim, it did not move fast enough on the claimant's request, and the *Harvey* decision shows how quickly things can go awry. Three days after the accident in *Harvey*, Geico advised the insured of his potential exposure above policy limits and his right to retain personal counsel. Six days after the accident, the decedent's estate's counsel contacted the insurer and requested a recorded statement from the insured to determine, among other things, the extent of the insured's assets. The insurer did not immediately relay this request to the insured, but three days later tendered policy limits to the estate's counsel (nine days after the accident).

The estate's counsel acknowledged receipt of the check but also the insurer's refusal to provide the requested statement. The insurer forwarded the response to the insured who had not known of a requested statement. The next day, the insured advised the insurer that he had retained personal counsel but could not meet with him regarding his financial situation for several days and asked the insurer to tell the estate's counsel that he was working on providing the information. The insurer did not relay that message to the estate's counsel. Approximately one month after the initial request for the statement, the estate's counsel returned the insurer's check and filed suit against the insured, which resulted in an excess verdict against the insured. The insured subsequently filed a bad-faith action against the insurer, and the jury found that the insurer had acted in bad faith. The insurer appealed, and the appellate court reversed.

The Florida Supreme Court quashed the appellate court's decision, holding that the appellate court erroneously concluded that the evidence was insufficient to show that the insurer acted in bad faith in failing to settle and that the insurer's actions did not cause the excess judgment. The Florida Supreme Court found that the insurer had not fulfilled its obligations to the insured merely by notifying the insured of settlement opportunities, advising him of potential excess exposure, recommending that he retain personal counsel, and tendering policy limits. The Court also rejected the appellate court's emphasis on the insured's conduct in its analysis because the focus is on the actions of the insurer. Thus, although Geico tendered its limits nine days after the accident, the Florida Supreme Court upheld a jury's finding of bad faith and an $8.47 million judgment.[33]

It is possible the law may change in the future, as (not to delve into politics) the *Harvey* decision was divided between liberal justices writing the majority opinion and conservative judges dissenting. Since the September 2018 ruling, three of the four majority justices on the *Harvey* decision have been replaced by a Republican governor. However, for the time being, insurers need to be paranoid and proactive in Florida.

The only state that follows the Florida approach is Oklahoma. Oklahoma courts have imposed an affirmative duty on insurers to initiate settlement offers. In *SRM v. Great Am. Ins. Co.*, the United States Court of Appeal for the Tenth Circuit held that under Oklahoma law, the duty of good faith "includes 'an affirmative duty to initiate settlement negotiations' if 'an insured's liability is clear and injuries of a claimant are so severe that a judgment in excess of policy limits is likely'."[34] Under *SRM*, Oklahoma imposes the same two-step analysis as Florida's Powell claim: 1) is liability clear? and 2) will a judgment likely exceed policy limits? If the answer to both of these questions is "yes," the insurer should affirmatively try to settle any claims.[35]

There are some basic "best practices" for handling claims in Florida and Oklahoma:

- Actively and aggressively investigate claims. Hire independent adjusters, seek out information—do not wait for information to be provided to you.
- Hire pre-suit counsel to analyze liability and damages in severe injury cases.
- When there is evidence of catastrophic injury (a person was airlifted from a scene, for example) and even *likely* liability of the insured, quickly address liability issues with pre-suit counsel to decide whether limits must be immediately tendered.

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33 One of the major procedural hurdles in Florida is that the question of bad faith failure to settle can seldom be resolved at the summary judgment stage and consequently almost always goes to a jury in light of Florida state courts' high burden on the moving party, the insurer, to "conclusively" show "that no material issues remain for trial." *Byrd v. BT Foods Inc*., 948 So.2d 921, 923-24 (Fla. 4th DCA 2007). This is a higher burden than federal courts impose.

34 798 F.3d 1322, 1325 (10th Cir. 2015) (citing *Badillo v. Mid Century Ins. Co.*, 121 P.3d 1080, 1095 (Okla. June 21, 2005).

35 *Ibid.*

- Communicate with the insured. Use such communications as an opportunity to document the overall approach to settlement. Give the insured the right to comment on the settlement approach.

- Do not wait to receive a letter of representation from a claimant's counsel before initiating settlement negotiations.

- Keep communications in writing. Do not rely on memory or phone calls for communications with the insured, claimant, or defense counsel.

- Consider hiring coverage counsel to manage the decision process.

- Consider designating a Florida "rapid response" team of adjusters and managers who understand the necessity (and subtlety) of affirmative settlement actions.

- Focus on the number of claimants and number of insureds, and refrain from immediately exhausting limits on a single claimant if there are numerous injured claimants or on behalf of a single insured if there are multiple responsible insureds.

Summary and Conclusions

As an obvious but incredibly important prerequisite to addressing these scenarios, insurers must know which state's law will apply to their claim. This is because states have dramatically varying interpretations of whether an insurer has an affirmative obligation to initiate settlement discussions. Remember that the applicable law may not always be obvious. For example, Florida law may apply to claims against a Florida-based amusement park company even if the claim involves injuries at the Michigan State Fair. Be wary of Oklahoma and extremely engaged in Florida with settlement checks at the ready. Stay vigilant about opportunities to settle in states like Kansas, Arizona, and Washington. In contrast, insurers are (currently) safe to wait for a settlement demand in Mississippi, Illinois, Texas, and California. Some final takeaways:

- The case law that policyholder and claimants' counsel are relying upon to support an affirmative settlement obligation is often not new, and we are expecting plaintiffs attorneys to try to wield those earlier decisions to support bad faith rulings. *See, i.e., First Acceptance Ins. Co. of Ga. v. Hughes,* 2019 Ga. LEXIS 161 (Ga. Mar. 11, 2019) (ultimately in favor of insurer). Thus, where there is law that supports an affirmative obligation, such as Arizona and Kansas, be careful not to create the next "Powell claim."

- Although the bad faith case law in the toughest regimes such as Florida and Oklahoma focuses on judgments in excess of policy limits, keep in mind that the affirmative obligation to settle may apply even when there is no excess exposure.
- Educate adjusters and managers about these different obligations.
- Document, document, document.
- **When in Florida or Oklahoma in a potentially catastrophic claim, DON'T WAIT, INITIATE (settlement discussions).**