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The Policyholder Law Firm



Your Insurance Company's Duty to Settle

By Robert M. Horkovich and Anna M. Piazza

A policyholder purchases liability insurance coverage to protect itself in the event it gets sued. Assuming a claim against the policyholder triggers its liability insurance policy, the insurance company will have a duty to defend the policyholder in the litigation against it and pay for a judgment against the policyholder. At some point in the litigation, the policyholder's liability may become clear. The insurance company, however, may prefer to roll the dice and proceed to trial. The policyholder, on the other hand, may want the insurance company to pay to settle the dispute. While the insurance company's liability is generally capped at the policy's limit of liability, the policyholder could end up liable for amounts in excess of policy limits.

To protect the policyholder in situations like these, courts have recognized a duty to settle on the part of the insurance company. When the policyholder's liability is clear and a judgment in excess of policy limits is likely, an insurance company has a duty to initiate settlement negotiations. An insurance company must accept a settlement offer that is reasonable and within

policy limits when a substantial likelihood exists that a verdict will exceed policy limits. This duty applies to primary as well as excess insurance companies.

The insurance company's failure to settle under such circumstances may constitute a breach of the insurance company's duty of good faith, a breach of the insurance company's fiduciary duty, a breach of the implied covenant of good faith and fair dealing, or give rise to a negligence claim. In some jurisdictions, the policyholder — and in limited instances, a third-party claimant — maintains a statutory right of action for an insurance company's failure to settle when liability has become reasonably clear. In fact, the Model Unfair Claims Practices Act — adopted by most states — provides that “not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear” constitutes an “unfair claims practice.”

The standards courts apply to determine whether the insurance company has breached its duty to settle vary. While in some jurisdic-

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tions the policyholder must show that the insurance company acted in bad faith, in other jurisdictions, mere negligence on the insurance company's part will support a failure to settle claim.

When an insurance company breaches its duty to settle, it can be held liable for the full verdict against the policyholder, including amounts in excess of policy limits. Some jurisdictions also allow the recovery of punitive damages, attorneys' fees, pre- and post-judgment interest, and damages for economic losses and emotional distress.

Triggering the Duty to Settle: State Requirements Vary

As a prerequisite to a failure to settle claim, some jurisdictions require that the insurance company receive a settlement demand within policy limits. In the case of third-party insurance, and depending on the applicable law, either the policyholder or the third-party claimant authors the letter. California, Illinois, Maryland, Minnesota, Missouri, New York and Texas require such a demand letter. In other words, in the absence of such a demand letter, the insurance company will likely not be held liable for failure to settle. Exceptions to this requirement in the third-party insurance context arise when the insurance company (1) denies coverage and refuses to defend or (2) fails to inform the policyholder of settlement offers.

Other jurisdictions only consider whether the policyholder or claimant made a demand, but do not deem the absence of a demand dispositive of a failure to settle claim. Kentucky, Montana and Ohio are such states. Besides considering whether the policyholder has demanded that the insurance company settle within policy limits, courts applying this approach consider whether (1) the verdict is likely to exceed policy limits, (2) the case's facts suggest that a verdict in the policyholder's favor is unlikely, (3) the insurance company has adequately considered its trial counsel's recommendations, (4) the policyholder has been informed of all settlement demands and offers, and (5) the insurance company has adequately considered any offer by the policyholder to contribute to a settlement. *See, e.g., Fowler v. State Farm Mut. Auto. Ins. Co.*, 454 P.2d 76, 79-80 (Mont. 1969).

In yet other jurisdictions, the absence of a demand letter will not affect the policyholder's bad faith claim. Arkansas, Colorado, New Mexico, New Jersey, Oklahoma, Tennessee and Wisconsin are such jurisdictions.

The recent decision of *SRM, Inc. v. Great American Insurance Company*, 798 F.3d 1322 (10th Cir. 2015) illustrates these concepts. In that case, injured train workers sought insurance coverage from a dump truck company's primary and umbrella insurance companies. While the primary insurance company was willing to offer its limits, the excess insurance company, Great American Insurance Company, refused. The case ultimately settled after mediation with each insurance company paying its limits and the policyholder paying an extra \$500,000 in excess of policy limits. The policyholder then sued Great American, claiming that Great American breached its duty of good faith and fair dealing by failing to investigate the injured train workers' claims and initiate settlement negotiations. Interpreting the policy language at issue, the court held that Great American had no implied duty to investigate claims or to initiate settlement negotiations until the primary insurance company exhausted its policy limits by paying the claim. The court noted, however, that the result may have been different had the injured train workers made a settlement demand within limits or had the primary insurance company proposed a settlement agreement.

Demand to Settle: Put It in Writing

To trigger the duty to settle, a demand letter should make a demand within policy limits. It should explain why liability is clear, explain why damages will likely exceed the policy limit, and contain a reasonable deadline for response.

It is important that the demand be made in writing. In jurisdictions where a settlement demand constitutes a prerequisite to a breach of the duty to settle claim, courts have ruled in the insurance company's favor when the claimant could provide evidence of only a vague request by counsel for policy limits. *See, e.g., Maldonado v. Allstate Ins. Co.*, 519 F. Supp. 2d 981, 992 (D. Minn. 2007) (noting that

the claimant could neither establish the date of the demand, nor provide supporting documentation).

An insurance company's duty to settle ensures that the insurance company will not unreasonably withhold settlement funds, elevating its interest in not paying over the policyholder's interest in a resolution within policy limits. The particular legal claim and remedies arising from an insurance company's failure to settle varies by jurisdiction. Similarly, depending on the applicable law, the absence of a demand letter could prove fatal to a policyholder's insurance claim. Accordingly, a policyholder should err on the side of caution and draft a demand letter, whether it is seeking insurance coverage for its own loss or for a potential judgment against it. ▲

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