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AVOIDING EXTRA-CONTRACTUAL EXPOSURE: WHEN DOES THE DUTY TO NEGOTIATE ARISE

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1. INTRODUCTION

Failing to settle a case within policy limits can have catastrophic effects for both the insured and insurer and recent cases have significantly changed the landscape concerning the duty to settle. The old rule that an insurer only had a duty to respond to a settlement demand within limits is being overhauled by courts that have concluded that a "claimant's interest in settlement" is enough to trigger a duty to initiate settlement discussions while others now seem to require that the carrier initiate settlement discussions when necessary to protect the insured, even when there has not been a formal demand.

As the panel will discuss issues dealing with real world application of these new legal principles, the panel believes that this handout would be most useful by providing a brief summary of the major cases that seem to be currently shaping this area of the law.

a. The *Du* Debacle

There are actually two *Du* decisions, *Du v. Allstate Insurance Company* 681 F 3rd 1118 (9th Circuit 2012), which we will refer to as *Du 1*, and *Du v. Allstate Insurance Company* 697 F 3rd 753 (9th Circuit 2012), which we will refer to as *Du 2*. In *Du*, the insured, Kim, was involved in an accident in which the four occupants of the second vehicle sustained injury. Kim's insurance policy had a liability limit of $100,000 for each claim and an aggregate of $300,000 for any one accident. Allstate's subsidiary, Deerbrook, attempted to get medical documentation from one of the injured parties, Du. Although no settlement demands or offers were made until June 9, 2006 when Du's lawyers submitted a $300,000 global demand for all four plaintiffs for the very first time, Du documented her medical costs in excess of $108,000. The other three claimants had medical costs substantially below that number. Deerbrook's adjuster responded that there was insufficient information about the other three claimants and suggested settling Du's claim separately, an idea which was rejected by counsel. Du filed a personal injury lawsuit against Kim and a verdict in excess of $4.1 million was returned. Kim assigned his bad faith claim to Du.

The court in *Du 1* ultimately found that the carrier did not have a duty to offer its policy limit because Deerbrook did not have proof of the injuries of the other three individuals and paying Du $100,000 could have left Kim unprotected if the remaining three claims exceeded $200,000. The court ultimately found that there was no evidence that Deerbrook should or could have made an earlier offer to Du and therefore supported the trial court's finding in favor of Deerbrook.

The amazing part of *Du 1* is that while holding the carrier did nothing wrong, the court put in very broad language about the carrier's duty to settle. The *Du 1* court goes on to state that the duty to settle requires an insurer to "effectuate settlement when liability is reasonably clear, even in the absence of a settlement demand." The court determines that a conflict exists when there is a significant risk of a judgment in excess of policy limits and there is a reasonable opportunity to settle within those limits. The court finds this is true regardless of whether a settlement demand has been made by the injured party. The court states that California courts have not directly addressed the question but notes that the 9th Circuit did in *Gibbs v. State Farm Mutual Insurance Company* 544 F 2nd 423 (9th Circuit 1976). As shown below, in the *Reid* discussion, *Gibbs* involved a case in which the insurer failed to conduct negotiations when faced with a clear interest expressed by the injured claimant. Therefore, the *Du 1* court may have mischaracterized it.

Du 1 also stated that California Insurance Code 790.03 (h), which enumerates that an insurer must attempt to effectuate the prompt and fair settlement of claims, mandated its result. However, as shown by the *Reid* decision below, the California Supreme Court has determined that 790.03 does not provide a civil remedy for third party claimants.

Immediately the legal press exploded with criticisms of *Du 1,* faulting the court for getting the issue wrong when its ultimate holding obviated the need to even address the settlement issue. Approximately three months later, the 9th Circuit filed an amended opinion in *(Du 2),* and on the issue of whether or not a settlement demand is required, the court now states:

> "We need not resolve these two legal issues because we find that in any event, the district court did not abuse its discretion in ruling there was no factual foundation for Du's proposed instruction. … In sum, there was no evidence that Deerbrook should or could have made an earlier settlement offer to Du. Accordingly, the district judge did not abuse his discretion in finding there was no evidentiary basis for Du's proposed instruction." (See Du at 759.)

All discussion of the legal issues involving when the duty to settle commenced were deleted from the opinion as a result of the uproar that followed.

b. *Reid v. Mercury Insurance Co.*, 220 CalApp 4th 262 (2013).

Reid is a California Court of Appeal decision which took the position that an insured does not have a duty to initiate settlement discussion or make an offer of policy limits in the absence of a settlement demand.

The trial court ruled in favor of Mercury Insurance on summary judgment and the claimant appealed alleging that Mercury breached its contract and the covenant of good faith and fair dealing by failing to make a settlement offer when liability in excess of the policy limit was "reasonably clear." Other allegations included that the carrier refused to inform Reid of the applicable policy limits.

The Court of Appeal found that for bad faith liability to attach to an insured's failure to pursue settlement discussions when there is exposure to a judgment beyond policy limits, there must minimally be some evidence that 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. If there is an absence of such evidence, there would be no "opportunity to settle that an insurer would have ignored.

The Court of Appeal found that there was no settlement offer from plaintiff and no evidence from which any reasonable juror could infer that the defendant knew or should have known that plaintiff was interested in settlement.

The court noted that cases have found that an insurer may be liable for bad faith refusal to settle without a settlement offer, but notes that none of the cases suggests that an insurer has a duty to initiate settlement discussions, or has an opportunity to settle, in the absence of any indication from the injured party that he or she is inclined to settle within the policy limits. The carrier specifically referred to *Boicourt v. Amex Assurance Co.* (2000) 78 Cal.App 4th 1390, in which the carrier had a blanket rule that it would not disclose policy limits to an injured claimant. The *Boicourt* court found that such a blanket policy might foreclose settlement opportunities which could have arisen and did so in an arbitrary manner. Therefore, in that circumstance, an actual demand was not required since an appropriate demand could really not be made.

The *Reid* court stated that the cases on point that did not require an actual demand involved at least circumstances where the claimant had conveyed to the insurer an interest in settlement and the insurer has either rejected or ignored the opportunity to take advantage of that interest to the benefit of its insureds. The court goes on to cite other cases in which there was not a formal settlement demand, but finds that all of the cases involve evidence that the insurer knew of the claimants interest in settlement and ignored it. For example, statements by the claimant stating it would be willing to settle for policy limits would be a statement that would indicate interest in settlement. The court also cited a New Jersey case, *Rova Farms Resort, Inc. v. Investors Insurance Company of America* AER (1974) 65 NJ475. In *Rova*, the court found that the absence of a formal request for settlement is merely one factor to be considered in a good faith assessment. The court acknowledged that while no formal demand had been presented in *Rova*, there were "a multitude of circumstances which should have impelled [the insurer] to energize a clearly attainable settlement" of the claim (see *Rova* at page 501), yet the insurer at no time increased the offer it made to settle which had been a fraction of its policy limit. The *Rova* court actually concluded: "the opportunities for settlement were so viable that it took a special genius at intransigence to kill them." (*Id.* at page 506.)

The *Reid* court then refers to the language in *Du 1*, stating the plaintiff in *Du 1* was asserting the same position that plaintiff was making in *Reid*. The court found that the *Du* court did not resolve the plaintiff's claim since the *Du* court agreed with the trial court that there was no evidentiary basis for the instruction. In summarizing, the court stated:

> "In summary, when a claimant offers to settle an excess claim within policy limits, an opportunity to settle exists and a conflict of interest arises, because a divergence exists between the insurers interest in paying less than the policy limits and the insured's interest in avoiding liability beyond the policy limit (cite omitted) and a conflict may also arise, without a formal settlement offer when a claimant clearly conveys to the insurer an interest in discussing settlement but the insurer ignores the opportunity to explore settlement possibilities to the insured's detriment, or when an insurer has an arbitrary rule or engages in other conduct that prevents settlement opportunities from arising." (Cite omitted.)

But, nothing like that happened here. *Reid* at page 278.

c. *Travelers Indemnity of Connecticut v. Art Specialty Insurance Company* 2013 WL 619 8966 (Eastern District of California 2013)

This Federal District Court decision seems to try to tread a middle ground between *Du* 1 and *Reid*. The court held that "the duty of an insured to effectuate settlement requires more than merely doing nothing while awaiting a formal written settlement demand. The insurer must act in good faith in response to reasonable opportunities to settle." (See opinion at page 11.)

In *Cox*, the court ruled against a Motion to Dismiss filed by Continental stating that the plaintiffs properly alleged a bad faith cause of action by stating that Continental acted in bad faith by disregarding the significant risk of an excess judgment when Continental ignored a letter which proposed settlement discussions from an attorney representing a plurality of the known and potential claimants involved in multiple claims of dental malpractice against the Continental insured.

d. *Jaimes v. Geico General Insurance Company* 534 Fed Appx 860 (11th Circuit 2013)

We all know about Florida and policy limit demands. In *Jaimes*, the court states that under Florida law, the insurer's good faith requirement obligates the insured to advise the insured of settlement opportunities, to advise as to the probable outcome of the litigation, to warn of the possibility of an excess judgment and to advise the insured of any steps he might take to avoid an excess judgment. Geico argued that it was entitled to judgment as a matter of law because the claimants did not make a demand on Geico, but the court cites another decision finding that lack of a formal offer to settle does not preclude a finding of bad faith.

e. *Powell v. Prudential Property & Casualty Insurance Co.* 584 Southern 2nd 12 at 14 (1991)

In *Powell,* the court held that an insurer has the duty to initiate settlement negotiations even without a demand when the insured's liability is clear and there is a likelihood of the judgment exceeding the policy limit. The *Powell* decision has been followed in many cases at this point and Florida law therefore does not appear to require a demand for policy limits as a prerequisite to a finding of bad faith.

f. New Jersey

New Jersey law is reflected in *Rova Farms Resort, Inc. v. Investor's Insurance Co.* 65 NJ 474 (1974), where the court held and an insurer has an affirmative duty to initiate settlement negotiations unless there is no realistic possibility of settlement within the policy limits and the insured will not contribute to a settlement figure above the policy limits.

g. Illinois

Pursuant to *Adduci v. Vigilant Insurance Co.* 98 Illinois App 3rd 472, 475 (1981), it appears that Illinois law does not require an insurance provider to start settlement negotiations on its own. However, this rule has been greatly eroded by the Illinois Supreme Court in *Haddick v. Valor Insurance* 198 Illinois 2nd 409 (2001) where an exception to the *Adduci* rule was adopted where "the probability of an adverse finding on liability is great and the amount of probable damages would greatly exceed policy limits."

h. Arizona

In *Acosta v. Phoenix Indemnity Insurance Co.* 214 Arizona 380 (2007), the court held that an insured's bankruptcy filing did not preclude a claim for bad faith failure to settle when the insurer could have offered to settle the case contingent on receiving approval from the Bankruptcy Court. The insurer attempted to argue that it could not settle because the insured was in bankruptcy but the court disagreed reasoning the insurer could have at least offered to settle with the claimant subject to Bankruptcy Court approval.

i. "Traditional Rule" States

The Idaho Supreme Court determined it would not extend its bad faith cause of action to encompass failures to investigate or failures to initiate settlement negotiations before suit was filed in *Morrell Construction, Inc. v. Home Insurance Co.* 920 F.2nd 576 (9th Circuit) (1990). Kansas appears to be governed by *Roberts v. Printup* 422 F.3rd 1211 (10th Circuit) (2005), which refused to rule that there was a "duty to initiate" settlement negotiations.

Also see:

Texas-*American Physicians Insurance Exchange v. Garcia* 876 Southwest 2nd 842 (1994);

Ohio -*Miller v. Kronk,* 35 Ohio App.3'd 103 (1987).