ENSURING SMOOTH SAILING – DUTY TO SETTLE AND TIPS FOR AVOIDING BAD FAITH EXPOSURE IN THIRD PARTY INSURANCE DISPUTES

William K. McVisk
Moderator
JOHNSON & BELL, LTD.
Chicago, Illinois
mcviskw@jbltd.com
Ensuring Smooth Sailing – Duty to Settle and Tips for Avoiding Bad Faith Exposure in Third-Party Insurance Disputes

William K. McVisk
JOHNSON & BELL, LTD.
Chicago

When a plaintiff’s attorney is asked to represent a seriously injured claimant, one of the first things the attorney considers is which potentially culpable party has the deepest pockets. It makes no sense for a plaintiff’s attorney, working on a contingency fee, to spend time and money pursuing a culpable defendant that has no assets.

Plaintiff’s attorneys have more options when a potentially liable defendant has insurance coverage. In the best of all worlds (from the perspective of a plaintiff’s attorney), the insurance coverage available will be adequate to cover any possible judgment. All is not lost for the plaintiff’s attorney when the culpable defendant has limited insurance coverage. In that case, the attorney can either settle quickly for the insurance limits, thereby minimizing the work put into the case, or he can attempt to set the insurer up for bad faith. If the bad faith setup is successful, the plaintiff can recover the entire amount of any judgment, even though it is far in excess of the insurance company’s limits. The challenge for the insurer in these cases is to dispose of the case for as little as possible, while not unnecessarily exposing either the insurer or the insured to an excess verdict by conduct a court would consider bad faith.

Bad faith law in the United States is not uniform. Courts in some states award damages for bad faith by recognizing an independent tort. Others characterize bad faith as a simple breach of the implied covenant of good faith and fair dealing inherent in every contract. Some courts impose heavy burdens on bad faith plaintiffs to establish that the insurer’s actions were both objectively unreasonable and committed with the knowledge that the insurer had no reasonable basis for its actions. Other courts have adopted a standard closer to negligence. The types of damages awarded also vary, with some courts requiring that the insurer comply with the policy terms and pay the insured’s attorney’s fees and others allowing damages for emotional distress. Some courts also allow recovery of punitive damages.

I. Bad Faith and the Settlement Process.

In the typical claim, with no coverage questions and with little likelihood of an excess verdict, there is little danger of a bad faith situation because the interests of the insured and the insurer are aligned. Both want to spend as little as possible defending the claim, want a defense judgment if possible, and if a defense judgment is unlikely or too costly to obtain, want to settle the claim for as little as possible.

In cases involving coverage issues or a realistic chance of an excess verdict, courts have concluded that the interests of the insurer and insured are divergent. While the best outcome for all would still be a defense judgment, the parties’ willingness to risk a large judgment may not be the same. For instance, if there is a substantial potential for an excess judgment, and if the case cannot be settled for substantially less than policy limits, the risk the insured faces from taking
the case to trial is substantially greater than the risk to the insurer. The insurer’s risk is limited to
the difference between the policy limit and the lowest settlement number the plaintiff will accept.
The insured’s risk is the difference between the policy limit and the total anticipated verdict, plus
the risk that a jury would return a verdict substantially greater than anyone expects. As one court
reasoned:

In the typical “duty to settle” case, the third party has sued the policyholder for an
amount in excess of the policy limits but has offered to settle the claim against the
policyholder for an amount equal to or less than those policy limits.

In this circumstance, the insurer may have an incentive to decline the settlement
offer and proceed to trial. The insurer may believe that it can win a verdict in its
favor. In contrast, the policyholder may prefer to settle within the policy limits
and avoid the risk of trial. The insurer may ignore the policyholder’s interest and
decline to settle.


If there is a potential for an excess verdict and the insurer has also asserted coverage
defenses, the parties’ interests may be even further out of line. For example, if there are credible
allegations that the insured acted intentionally, and the insurer has reserved the right to deny
coverage for damages resulting from intentional acts, the insurer’s interests would be served by
either a defense verdict or a verdict finding that the insured acted intentionally, so that any award
would not be covered. The insured would also be served by a defense verdict, but if the verdict
is adverse, the insured would be best served by a finding of negligence, with no finding of intent,
so the judgment would be covered. If there is a substantial likelihood that a verdict will exceed
the policy limits, the insured would be best served by a settlement for any amount up to the
policy limit. However, the insurer may have little to lose by taking the case to trial, since a
defense verdict or a verdict finding the insured acted intentionally would result in no indemnity
payment, while it may take all or most of the policy limit to settle the claim. As one court
explained:

_[T]he insurer’s duty to effect reasonable settlement … stems from the relationship
between the insurer and the insured under the policy. The fundamental promise
of the insurer is to pay all damages for which the insured becomes legally
obligated up to the policy limits. The insurer is entitled to control the defense of
any action, including settlement negotiations. When there is a likelihood liability
may exceed policy limits and there is an opportunity for settlement within policy
limits, the interests of the insurer will be in conflict with those of the insured. The
duty to effect reasonable settlement is imposed on the insurer to compel it to give
as much consideration to the interests of the insured as it does to its own._

415 (1978).
When excess insurers are added to this mix, it becomes more complex. Depending on the exposure presented, the excess insurer may be aligned with the insured in trying to get the case settled within the primary layer, or it may be the party urging a slow approach to settlement, because it hopes to lower the plaintiff’s expectations. With respect to coverage issues, the excess carrier will generally be aligned with the primary carrier, but may have even more incentive to stress the lack of coverage because the excess carrier’s total exposure may be substantially greater than the exposure of the primary carrier. Also, where the case is clearly going to result in a verdict in excess of the primary layer, the primary carrier may have an incentive to take shortcuts in defending the claim, since the exposure from an adverse verdict will mostly be borne by the excess carrier, which is not contributing to defense costs. Therefore, excess insurers often try to pressure primary carriers to settle the underlying claim within their limits or to increase their defense efforts to foster a better trial outcome.

Most insurers understand these conflicting interests and take steps to ensure that they give due consideration to the interests of the insured. Indeed, most insurers recognize that their insureds are their customers, and the long range interests of the insurer will best be served by treating the insured fairly. However, because of the large stakes involved, the obvious differences between the financial interests of the insured and the insurer and the willingness of some courts and juries to assume the worst about insurance companies, these situations can be dangerous and require careful management to avoid a bad faith award.

Courts have recognized that each party to the insurer/insured relationship has various duties. It is up to the insurer to take steps to demonstrate that it is complying with its duties.

A. The insured.

1. The insured has the duty to cooperate with the insurer’s defense and investigation and with efforts to settle the case within the insurer’s coverage.


B. The primary insurer.

1. The insured is precluded from settling the claim, except at its own expense while the insurer has exclusive control over settlement negotiations and the defense. This “necessarily creates a conflict of interest between the insurance provider and its insured.” Haddick v. Valor Insurance, 198 Ill.2d 409, 415, 763 N.E.2d 299, 303 (2001). As a result, the “insurer must take the insured’s settlement interests into consideration.” Id., 198 Ill.2d at 416.

   a. Under most liability policies, the insurer has the right both to defend the claim and to settle the claim. Without a bad faith remedy, an insurer would have little incentive to settle for policy limits or for an amount near the policy limits, as the
risk of an excess verdict is borne by the insured or the insured’s excess carriers. *Haddick*, 198 Ill.2d at 415, 763 N.E.2d at 303.

b. The insurer has a duty to act in good faith when considering settlement if there is a potential for an excess verdict.


- Other states have held that the primary carrier does not owe a direct duty to the excess insurer, but the excess insurer can be subrogated to the rights of the insured. *E.g.*, *Scottsdale Ins. Co. v. Addison Ins. Co.*, 448 S.W.3d 818, 833 (Mo. 2014); *Sequoia Ins. Co. v. Royal Ins. Co.*, 971 F.3d 1385, 1391 (9th Cir. 1992); *Commercial Union Ass. Co. v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 164 Cal.Rptr. 709 (1980); *American Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex. 1992); *Commercial Union Ins. Co. v. Medical Protective Co.*, 426 Mich. 109, 119 393 N.W.2d 479 (1986).


2. Excess insurers.

a. An excess carrier also has a duty to protect the insured and higher layer excess carriers when it has control over the settlement. *Central Illinois Public Service Co. v. Agricultural Ins. Co.*, 378 Ill. App. 3d 728, 735, 880 N.E.2d 1172 (5th Dist. 2008); *Associated Wholesale Grocers v. Americold Corp.*, 261 Kan. 806, 830, 934 P.2d 65 (1997). As the court stated in *Central Illinois Public Service*, “the pronouncements of Illinois courts regarding the duties of primary carriers describe the responsibilities of excess carriers.” *Id.* However, this assumes that the excess carrier has some degree of control over settlement and the litigation. An excess insurer that controls the settlement process has a duty to settle, but an excess insurer that has no control over settlement, presumably because the primary carrier’s limit has not been exhausted or offered, does not owe a duty to settle. *Id.* at 735-36.


   c. Duty to communicate to the insured concerning settlement demands and opportunities as well as the merits of the case and the likelihood of winning and losing. *E.g.*, *Tank v. State Farm Fire & Casualty Co.*, 105 Wn.2d 381, 388-89 715 P.2d 1133 (Wash. 1986).

C. Duty to Settle – Courts have characterized the duty to settle in various ways. Some refer to the obligation of the insurer to act in good faith, indicating that an insurer must act in bad faith to breach the duty. *PPG Industries, Inc. v. Transamerica Ins. Co.*, 20 Cal. 4th 310, 314, 975 P.2d 652, 84 Cal. Rptr. 2d 455, (1999) (“Implied in every contract is a covenant of good faith and fair dealing that neither party will injure the right of the other to receive the benefits of the agreement. [Citation omitted.] This covenant imposes a number of obligations upon insurance companies, including an obligation to accept a
reasonable offer of settlement. [Citations omitted.] An insurer’s breach of the implied covenant of good faith and fair dealing ‘will provide the basis for an action in tort.”) Others require the insurer to use ordinary care to manage the settlement process, and consider the breach of the duty to settle on a negligence standard. E.g., Boston Old Colony Ins. Co. v. Gutierrez, 386 So. 2d 783, 785 (Fla. 1980) (“An insurer, in handling the defense of claims against its insured, has a duty to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business.”); Hartford Casualty Ins. Co. v. New Hampshire Ins. Co., 417 Mass. 115, 628 N.E.2d 14, 17 (1994) (adopting negligence standard for insurer’s duty to settle.). All make it clear that the insurer must give equal consideration to the insured’s interests in settling a claim as to its own.


b. The insurer is not required to place the insured’s interests ahead of its own in determining whether to settle. It is required to give the insured’s interests equal weight to its own interests in considering settlement. E.g., Stetler v. Fosha, 809 F. Supp. 1409, (D. Kan. 1992); Clearwater v. State Farm Mut. Auto. Ins. Co., 164 Ariz. 256, 259, 792 P.2d 719 (Ariz. 1990). One way to view this is with the following test:


- In Massachusetts the test is whether, assuming no liability limit, no reasonable insurer would have refused the settlement offer or would have failed to respond to the settlement offer. Hartford Casualty Ins. Co. v. New Hampshire Ins. Co., 417 Mass. 115, 628 N.E.2d 14, 18 (1994).

- In most states, if there is no probability of an excess verdict or of a liability finding against the insured, or if there is no potential for settling the claim within the policy limits, no duty to settle arises. Powell v. Am. Serv. Ins. Co., 2014 IL App (1st) 123643, 7 N.E.3d 11, (2014)(must be reasonable probability of both adverse verdict and that verdict will exceed policy limit); Olympia Fields Country Club v. Bankers Indemnity Insurance Co., 325 Ill. App. 649, 670-71, 60 N.E.2d 896 (1945), quoting Hilker v. Western Automobile Insurance Co., 204 Wis. 1, 14, 235 N.W. 413, 414 (1931) (“When damages sought by a third party against the insured do not exceed policy limits, the question of whether the claim be compromised or settled, or the manner in which it shall be defended, is a matter of no concern to the insured.”)(internal quotations omitted).
However, in California, the lack of an excess judgment is not a complete bar
to a bad faith action where the insurer’s misconduct goes beyond the failure to
settle within policy limits. See, J.B. Aguerre, Inc. v. American Guarantee &
(insurer used insured’s fear of punitive damages to coerce the insured to
contribute to settlement). Also, California courts have ruled that the duty to
settle is not limited to cases presenting excess exposure to the insured.
Cal. Rptr. 3d 42, (Cal. App. 1st Dist. 2010) (“An insurer’s wrongful failure to
settle may be actionable even without rendition of an excess judgment.”);
Rptr. 177 (1987) (delayed settlement damaged insured’s business goodwill);
Rptr. 215 (1986) (insurer settled claim without insured’s consent).

Most courts have refused to recognize a duty to settle in the absence of a
demand within policy limits. E.g., American Physicians Ins. Exch. v. Garcia,
876 S.W.2d 842, 849 (Tex. 1994); c. The Illinois Supreme Court recognized that an insurer has a duty to act in good
Ill.2d 513 (Ill. 1997).

Similarly, the New Mexico Supreme Court ruled that an insurer has a duty to
act in good faith to effectuate prompt, fair and equitable settlements in cases
involving reasonably clear liability. Hovet v. Allstate Ins. Co., 135 N.M. 397,

d. In Nevada, a claim for failure to settle requires a showing that the insurer
exercised a “deliberate refusal to discharge its contractual duties.” Allstate Ins.
Co. v. Miller, 125 Nev. 300, 318 (2009).

e. Generally, courts have looked to the following factors in determining whether an
insurer breached the duty to settle.

- Extent of insurer’s investigation. Was it adequate to form a determination as
to whether an excess verdict was likely? E.g., Boston Old Colony Ins. Co. v.
Gutierrez, 386 So. 2d 783, 785 (Fla. 1980) (Insurer must investigate the facts.
Duty of good faith involves diligence and care in the investigation and
evaluation of the claim against the insured.); Bollinger v. Nuss, 202 Kan. 326,
339 (Kan. 1969) (one factor considered in determining whether insurer acted
in good faith is whether the insurer failed to properly investigate to ascertain
the evidence against the insured.)

- Advice of defense counsel regarding likely outcome. Did the insurer reject its
own defense counsel’s advice concerning the outcome of the case and
settlement?
➤ Advice of claims adjuster handling file regarding likely outcome. Did the insurer reject the advice of its claims adjuster in determining the likely outcome of the case and settlement?

➤ Whether insurer advised insured of demands and kept insured informed of case status and evaluation.

➤ Whether insurer engaged in negotiations. Refusal to negotiate indicates bad faith.

➤ Substantial likelihood of excess verdict.

- In some jurisdictions, an insured must show that a reasonable insurer would have settled the claim. *Goodson v. Am. Std. Ins. Co.*, 89 P.2d 409, 415 (Colo. 2004).


➤ Other courts have listed factors including the severity of the plaintiff’s injuries giving rise to a likelihood of an excess verdict, the lack of skillful evaluation of the plaintiff’s disability, pressure by the insurer on the insured to contribute to settlement within the policy limits as an inducement on the insurer to contribute to settlement, and actions demonstrating a greater concern with the insurer’s monetary interests than the financial risk posed to the insured. *State Farm Mut. Auto. Ins. Co. v. White*, 248 Md. 324, 332, 236 A.2d 269 (1967).

➤ Another factor courts have considered is the failure to disclose policy limits to the claimant. *Powell v. Prudential Property & Cas. Ins. Co.*, 584 So.2d 12, 14 (Fla. App. 1991).

f. Timing of Duty to Settle.

➤ Presuit: Even though the insurer has no duty to defend before a lawsuit is filed, an insurer may be obligated to settle before suit is filed. The Illinois Supreme Court ruled that a “duty to settle arises once a third-party claimant has made a demand for settlement of a claim within policy limits and, at the time of the demand, there is a reasonable probability of recovery in excess of policy limits and a reasonable probability of a finding of liability against its insureds.” *Haddick v. Valor Insurance*, 198 Ill.2d 409, 419 (2001).
Duty to initiate settlement negotiations before demand. Courts have issued conflicting decisions about whether an insurer can be in bad faith for failing to settle where the plaintiff never made a demand for settlement within limits.

- The Kentucky Supreme Court found that while the insurer has a duty to its insured to settle claims within its policy limits when it can reasonably do so, that duty does not arise until a claimant makes a demand within the policy limits. There is no affirmative duty on the carrier to seek out the claimant and offer settlement in order to avoid a charge of bad faith. *Davis v. Home Indem. Co.*, 659 S.W.2d 185, 189 (Ky. 1983). See also, *Miller v. Kronk*, 35 Ohio App. 3d 103, 519 N.E.2d 856 (Ohio App. 1987)) (no duty to initiate settlement negotiations where none has been initiated by plaintiff).

- One court indicated that the duty to initiate negotiations does not arise in the absence of some indication from the plaintiff that he or she is willing to settle within limits, or in excess of limits with the insured is willing to pay the excess. *Reid v. Mercury Ins. Co.*, 220 Cal.App.4th 262, 273 (Cal.App. 2013).

- Other courts have held that the insurer is obligated to effectuate settlement when liability is reasonably clear, even in the absence of a settlement demand. *Du v. Allstate*, 681 F.3d 1118, 1123 (9th Cir. 2013) (opinion withdrawn 697 F.3d 753) (California law); *Travelers Indem. Of Conn. v. Arch Specialty Ins. Co.*, 2013 U.S. Dist. Lexis 169543 (E.D. Cal. 2013); *Powell v. Prudential Property & Casualty Ins. Co.*, 584 So. 2d 12, (Fla. App. 1991) (lack of settlement demand does not preclude finding of bad faith. Where liability is clear and injuries are so serious that excess judgment is likely, insurer has affirmative duty to initiate settlement negotiations.); *City of Hobbs v. Hartford Fire Ins. Co.*, 162 F.3d 576, 584 (10th Cir. 1998); *Maine Bonding & Cas. Co. v. Centennial Ins. Co.*, 298 Ore. 514, 693 P.2d 1296, 1299 (1985); *Alt v. American Family Mutual Insurance Co.*, 71 Wis. 2d 340, 351, 237 N.W.2d 706 (1976); *American Physicians Ins. Exch. V. Garcia*, 876 S.W.2d 842, 864 (Tex. 1994) (insurer has affirmative duty to explore settlement possibilities).

In Oregon, an insurer may be found negligent in failing to settle where an opportunity to settle exists and the choice not to settle creates an unreasonable risk to the insured. *Georgetown Realty v. Home Ins. Co.*, 313 Ore. 97, 109 (Ore. 1991).

g. Ability of insured to stipulate to excess judgment when insurer does not settle. Some courts have held that if the insurer does not settle in response to a reasonable settlement demand, the insured may stipulate to the entry of an excess judgment, in which case the insurer will be liable for the full judgment, provided that it is reasonable and not the result of fraud or collusion. E.g., *Nunn v. Mid-
h. Independent counsel. One court has ruled that an insured has the right to independent counsel, at the insurer’s expense, when there is a non-trivial probability of an excess verdict, and that the insured can then settle the suit for an amount within coverage and then recover from the insurer. *R.C. Wegman Construction Co. v. Admiral Insurance Co.*, 629 F.3d 724, rehearing denied, 634 F.3d 371 (7th Cir. 2011) (predicting Illinois law). But see, *Allstate Ins. Co. v. Campbell*, 334 Md. 381, 396-97, 639 A.2d 652 (1994)(no right to independent counsel at insurer’s expense simply because insurer rejects settlement demand within limits.)

D. Damages for Failure to Settle – Akin to the damages recoverable in the bad faith failure to defend, states impose varying forms of damages for an insurer’s bad faith failure to settle.


   b. Other states have limited the amount of recovery to the amount of coverage provided in the policy. *Dumas Brothers Manufacturing Company, Inc. v. Southern Guaranty Insurance Company*, 431 So.2d 534 (Ala. 1983).

   c. Other courts have allowed claims for loss of consortium due to the emotional distress caused to a spouse when an insurer fails to settle in bad faith. *Robin v. Allstate Ins. Co.*, 844 So.2d 41, 47 (La.App. 2003).

   d. Courts have also allowed the insured to recover damages for loss of credit rating, business reputation and emotional distress in cases where the insurer knew or should have known that such injuries would be incurred as a result of the insurer’s bad faith failure to settle. *Birth Center v. St. Paul Cos.*, 567 Pa. 386, 407, 787 A.2d 376, 389 (Pa. 2001).

   e. Additionally, courts have allowed the insured to recover the value of a business destroyed as the result of the failure to settle. *Aetna Life & Cas. Co. v. Little*, 384 So.2d 213, 216 (Fla.App. 1980).

   f. Courts have allowed the insured to recover the amount of the judgment in excess of the policy limit, even when the excess judgment represented punitive damages awarded against the insured. *Kransco v. American Empire Surplus Lines Ins. Co.*, 23 Cal.4th 390, 410, 97 Cal. Rptr. 2d 151 (2000).

   g. Finally, courts have allowed punitive damages where evidence indicates that the insurer acted with an intent to injure the insured or acted in reckless disregard of
769 N.E.2d 100 (5th Dist. 2002); Campbell v. State Farm Mut. Auto. Ins. Co., 98
3d 783, 793 (Cal.App. 1975); Newport v. USAA, 2000 OK 59, 11 P.3d 190, 204
(OK 2000).

II. Duty to settle and coverage issues.

A. Courts are split on whether an insurer may defend a bad faith case on the basis of a
reasonable dispute concerning coverage.

B. Some courts hold that if the insurer fails to settle a claim presenting a likelihood of an
excess verdict because of coverage issues, and then loses the coverage defense, the
insurer is liable for the full amount of the verdict.

the court held that an insurer’s reasonable and legitimate basis for denying coverage
was relevant to the question of bad faith, but not dispositive. The court held that in
determining bad faith in such situations, the court should consider whether the insurer
was able to obtain a reservation of rights or deny coverage if a defense was provided,
efforts or measures taken by the insurer to resolve the coverage dispute promptly or in
such a way as to limit the prejudice to the insureds, the merits of the coverage dispute
– i.e., the weight of authority favoring the insurer’s position, the insurer’s diligence
and thoroughness in investigating the facts pertinent to coverage, efforts made to
settle the liability claim in the face of the coverage dispute.

2. If an insurer wrongfully denies coverage it is liable for the full amount of the verdict.
Camelot by the Bay Condominium Owners’ Assn. v. Scottsdale Ins. Co., 27

C. Other courts have ruled that it is not bad faith to refuse to settle an insured’s claim within
policy limits if the question of coverage is fairly debatable and when the grounds for
refusal would entirely defeat the insurer’s indemnity responsibility. Mowry v. Badger
State Mutual Ins. Co., 129 Wis.2d 496 (1986); Stevenson v. State Farm Fire & Casualty
Co., 257 Ill. App. 3d 179 (1st Dist. 1993)

III. Managing the Settlement Process to Avoid Bath Faith

The failure to follow the advice of defense counsel and adjusters in and of itself indicates
1995). The refusal to negotiate is another indication of bad faith. Also indicative of bad faith is
the insurer’s failure to keep the insured informed of negotiations and the substantial prospect of
an adverse verdict and potential that such a verdict will exceed the policy limits. Truck Ins.
Exchange v. Bishara, 128 Idaho 550, 916 P.2d 1275 (Idaho 1996); Lafauci v. Jenkins, 844 So.2d
O’Neill, supra, at note 32, 329 Ill.App.3d at 1174.
IV. Non-Coverage Cases presenting excess exposure.

A. The Primary Carrier

1. Communication.

   ➢ With insured.


   • The Supreme Court of Idaho established an “equality of consideration” test that requires consideration of seven factors, including whether the insurer failed to communicate the insured of settlement offers. *Truck Ins. Exch.*, 128 Idaho at 554.

b. Preventative measures to avoid bad faith:

   ➢ Advise insured of excess potential as soon as possible.

   ➢ Advise insured of all demands and overtures for settlement.

   ➢ Invite the insured to discuss settlement with the claims personnel for the carrier and to make its views known.

   ➢ Recommend independent counsel to advise insured concerning its excess potential.

c. With defense counsel.

   ➢ Make sure defense counsel knows what you need to evaluate the case. Without a good investigation and reasonable assessment of both the potential liability and the potential damages, the insurer is not able to determine the best response to settlement demands.

   ➢ Make sure defense counsel keeps the insurer well informed of all settlement overtures from plaintiff, as well as suggestions from the court for mediation or settlement.

   ➢ Make sure defense counsel advises the insured of settlement demands, as well as advising the insurer of the demands.

d. With excess carriers.

   ➢ Report on status and evaluation to excess carriers – keep them in the loop.
Invite their participation in decision and case roundtables.

e. With plaintiff.

- Don’t ignore settlement demands – particularly those with deadlines!
- Respond to demands – even if it is to express the need for more time.
- Follow through when you ask for more time.
- Once you determine that liability is likely and that a verdict is likely to exceed policy limits, explore settlement opportunities. Do not wait for a demand.

f. With management.

- Be careful what is written to management. It will form the basis of the bad faith suit.
- Be sure management has information it needs to determine whether to settle—including full evaluation of both liability and potential damages, strengths and weaknesses of the case.

2. File documentation.

a. Be sure your settlement decisions are well documented to support the decision you make.

b. Documentation needs to include:

- Full evaluation of liability – what is the basis for your belief that you will win at trial?
- Defense counsel’s evaluation of liability.
- Discussion of strengths and weaknesses of liability case.
- Discussion of co-defendants’ positions and their impact on your case.
- Evaluation of strengths of witnesses.
- Full evaluation of damages.
  - What are the economic damages?
  - What are the non-economic factors that will affect damages?
  - Jury verdict research if available.
- Documentation of communications with insured.
Documentation of insured’s settlement position.
Documentation of communications with plaintiff.
Documentation of communications from trial judge or mediator.
Documentation of communications with excess carriers.
Documentation of communications with management.

B. Insured.

1. Remember, the insurer is on your side most of the time.

2. Hammer letters have the following effects:
   a. Make it clear you consent to settlement.
   b. Increase pressure on primary carrier.
   c. Increases primary carrier’s defensiveness.
   d. Is of little value in bad faith suit unless it is persuasive.

C. Excess insurer.

1. See rules re primary insurer.

2. Excess insurer needs to both support primary insurer while persuading the primary insurer to act in a reasonable way to avoid prejudicing the excess.

3. Best course is to discuss with the primary carrier and the insured to work together toward settlement.

4. Need to ally with the insured to put pressure on primary carrier.

D. Defense counsel.

1. Needs to give an objective analysis of likely settlement and verdict outcomes.

2. All parties need to know the strengths and weaknesses of the case.

3. All parties need to have defense counsel’s best estimates of likelihood of defense verdict and likely verdict range if plaintiff’s verdict.

V. Managing Excess Cases with Coverage Issues.

A. Carefully consider whether to defend subject to a reservation of rights or file a declaratory action.
1. Courts will generally look favorably on a decision to defend, despite coverage issues, provided that defense is well managed and the insured is well informed of the coverage issues and potential conflicts.

2. In many states, providing a defense will mean retaining independent counsel to represent the insured at the insurer’s expense.

3. Courts may also view a decision to file a declaratory action as a reasonable attempt to resolve coverage issues early, so that if there is coverage, the insured is not exposed to an excess verdict because the insurer fails to make an offer.

4. However, the option of filing a declaratory action may not be open if there is a duty to defend, since the duty to indemnify is premature until the underlying case resolves.

5. Also, if resolution of the coverage issue requires resolution of an issue central to the underlying suit (such as intent vs. negligence), the court will not be able to resolve the issue in the coverage suit.

B. Consider whether to let the plaintiff know about the coverage issues.

1. In many cases, if plaintiff is aware of the coverage issues in adequate time, they will adjust their expectations regarding settlement, and may accept a smaller settlement, depending on the assets available to the insured to cover a verdict.

2. In many states, if the insurer seeks a declaratory judgment about coverage issues, the plaintiff is a necessary party to the suit. E.g., Western States Ins. Co. v. Weller, 299 Ill.App. 3d 317, 320, 701 N.E.2d 542 (Ill.App. 1998).

3. However, to the extent that the plaintiff is aware of coverage issues, the plaintiff may seek to focus allegations and evidence in favor of coverage.

C. Make sure the file documents a careful investigation into the coverage issues, and efforts to reach final resolution of the issue as soon as possible.

1. Obtain coverage opinion from outside counsel. (It is likely that insurer won’t want to rely on this opinion as proof that they were not in bad faith, since it would waive privilege to do so, but it is still important to obtain it.)

2. Carefully and promptly investigate all factual issues needed to resolve coverage issues.

D. Be sure to advise insured of coverage issues and encourage the insured to retain independent counsel to advise it concerning coverage issues.

E. Consider whether the coverage issues create a conflict that requires the insurer to pay for independent defense counsel.
F. If coverage issues are debatable, but not clear, consider attempting to settle the claim with the claimant, using the coverage problems as a basis to settle more cheaply.