



Bad faith: Revisiting an insurer's affirmative duty to settle

Absent a settlement demand, insurers have no duty to present a settlement offer where a verdict is likely to exceed the policy limit

BY CHARLES M. MILLER

Under current California law, an insurer does not have an affirmative duty to settle claims brought against its insured before there is a settlement demand. This is the case even where it is foreseeable that, if a claim against the insured is not settled, the insured may face liability for damages in excess of the policy limit.

Not only is this position contrary to well-reasoned decisions in other jurisdictions, it is also contrary to the insurance industry's own practice. The insurance industry has routinely and historically adopted a policy of seeking to settle claims before there is a settlement demand. Often, the performance of adjusters is evaluated based on their ability to settle claims on the first call. What the insurance industry has sought to do is carve out a narrow exception to its own practice: Insurers have no obligation to affirmatively present a settlement offer where there is a likelihood of a verdict in excess of the policy limit absent a settlement demand. This "carve-out" is contrary not only to the insurer's duty of good faith and fair dealing, but also to the insurance industry's own practice.

The purpose of this article is threefold. First, it addresses the recent California decisions that have held that an insurer does not have a duty to affirmatively make settlement offers absent a settlement demand. Second, it summarizes those decisions in other states which have held that an insurer does have an affirmative duty to settle, and thereby casts doubt on the reasoning that supports the

current law in California. Third, it demonstrates that the insurance industry itself has assumed the duty to settle claims even before a settlement demand has been received. Because the insurance industry has assumed the duty to settle claims before there is a settlement demand, the carve-out the industry seeks cannot be supported.

Accordingly, the decision in *Reid v. Mercury Insurance Company* (2015) 220 Cal.App.4th 262, should not be followed by other courts when those courts are presented with the well-reasoned decisions of other state courts, along with evidence of the insurance industry's own practice of settling claims against their insureds before there is a settlement demand. A decision based on these two pillars would eliminate the insurance industry's carve-out and restore the insurer's affirmative duty to settle to all claims presented against their insureds.

California cases

Recent decisions in California have not found that an insurer has an affirmative duty to settle claims absent a settlement demand.

In *Du v. Allstate Insurance Company, et al.* (9th Cir. 2012) 681 F.3d 1118, the appellate panel initially 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" (*Id.*, p. 1122). Upon reconsideration, however, the *Du* court backed off its original holding, and found that it did not need to reach the issue of whether an insurer has an affirmative duty to settle because "[t]he district court

found that, 'the issue of settlement was broached at a sufficiently early time in the litigation that it vitiates any claim or effective claim insofar as a failure to initiate a settlement discussion'" (*Du v. Allstate Insurance Company*, 681 F.3d 1118, op. mod. 697 F.3d 753, 758). Accordingly, the issue of whether an insurer had an affirmative duty to settle remained unsettled.

This condition prevailed until the California Appellate Court decision in *Reid v. Mercury Insurance Company, supra*, 220 Cal.App.4th 262. In *Reid*, the Court held that, "In the absence of a settlement demand or any other manifestation the injured party is interested in settlement, when the insurer has done nothing to foreclose the possibility of settlement, we find there is no liability for bad faith failure to settle" (*Id.*, at 266). In reviewing the facts of the case, the Court observed that "there was no settlement offer from plaintiff, and no evidence from which any reasonable juror could infer that defendant knew or should have known plaintiff was interested in settlement" (*Id.*, at. 272).

The Court rested its decision, in part, on the following statement in *Merritt v. Reserve Ins.* (1973) 34 Cal.App.3d 858:

It is apparent . . . (1) the legal rules relating to bad faith come into effect only when a conflict of interest develops between the carrier and its insured; (2) a conflict of interest only develops when an offer to settle an excess claim is made within policy limits or when a settlement offer is made in excess of policy limits and the insured is willing and able to pay the excess.

Accordingly, an insurer only has an obligation to make a settlement offer



when the conflict of interest arises, not before, and that conflict only arises when a settlement demand is made.

In addressing out-of-state decisions to the contrary, the court noted that those cases “involve[d] circumstances where the claimant has conveyed to the insurer an interest in settlement,” or “the insurer knew of the claimant’s interest in settlement and ignored it.” This observation is of particular importance here, because insurers commonly know of a claimant’s interest in settlement and, therefore, seek to settle claims early.

Indeed, the duty of good faith and fair dealing is not solely triggered by a conflict of interest, but rather, it is an inherent part of an insurer’s obligation to its insured. (See *Murphy v. Allstate Ins. Co.* (1976) 17 Cal.3d 937, 941 [duty to settle is implied in law to protect the insured from exposure to liability in excess of coverage].) But even of greater importance are the facts not considered by the *Reid* court. The insurance industry itself has recognized and acknowledged its affirmative duty to settle, and has even put into place programs to encourage claims adjusters to affirmatively settle claims even before there is a settlement demand. In other words, the insurance industry has assumed the duty to affirmatively settle claims.

Decisions of other courts

Numerous other courts have held that an insurer does have an affirmative duty to settle claims even before a settlement demand is made. In *Coleman v. Holecek*, (10th Cir. 1976, 542 F.2d 532, 537), the Court, applying Kansas law, noted that:

[t]he duty to consider the interests of the insured arises not because there has been a settlement offer from the plaintiff but because there has been a claim for damages in excess of the policy limits. This claim creates a conflict of interest between the insured and the carrier which requires the carrier to give equal consideration to the interests of the insured. This means that

‘the claim should be evaluated by the insurer without looking to the policy limits and as though it alone would be responsible for the payment of any judgment rendered on the claim.’ When the carrier’s duty is measured against this standard, it becomes apparent that the duty to settle does not hinge on the existence of a settlement offer from the plaintiff. Rather, the duty to settle arises if the carrier would initiate settlement negotiations on its own behalf were its potential liability equal to that of its insured. (*Id.*, at. 537; citations omitted)

The decision in *Coleman* directly undermines the analysis in *Reid* that a conflict arises only when a settlement demand is made. Clearly, when a claim is presented, insurance “adjusters have knowledge as to the value range of liability claims” (*Cooper v. State Farm Mut. Auto. Ins. Co.* (2009) 177 Cal.App.4th 876, 889). Therefore, adjusters know when there is the potential for a verdict in excess of the policy limit, and they do not need a demand to tell them that.

Other courts have adopted similar holdings (See, e.g., *City of Hobbs v. Hartford Fire Ins. Co.* (10th Cir. 1998) 162 F.3d 576, 586 [applying New Mexico law and finding that an insurer can be liable for a bad faith failure to settle, even though a claimant has not submitted a firm reasonable offer]; *Maine Bonding & Cas. Co. v. Centennial Ins. Co.* (1985) 298 Or. 514, 519, 693 P.2d 1296, 1299 [holding that under Oregon law, an insurer’s duty “may require that an insurer make inquiries to determine if settlement is possible within the policy limitations”]; *Alt v. American Family Mut. Ins. Co.* (1976) 71 Wis.2d 340, 350, 237 N.W.2d 706, 713 [“All prior Wisconsin cases indicate that an insurance company has more than a passive role – that, in some circumstances at least it has an affirmative duty to seize whatever reasonable opportunity may present itself to protect its insured from excess liability”]; *Rova Farms Resort, Inc. v. Investors Ins. Co. of Am.* (1974) 65 N.J. 474, 493, 323 A.2d 495, 506-07 [“We . . . hold that an insurer

. . . has a positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage. Any doubt as to the existence of an opportunity to settle within the face amount of the coverage . . . must be resolved in favor of the insured unless the insurer, by some affirmative evidence, demonstrates there was not only no realistic possibility of settlement within policy limits, but also that the insured would not have contributed to whatever settlement figure above that sum might have been available;”] *State Auto. Ins. Co. v. Rowland* (1968) 221 Tenn. 421, 433-34, 427 S.W.2d 30, 35 [“to hold as a matter of law that an [insurer] cannot be guilty of bad faith unless it received an offer . . . within the policy limits could most certainly lead to inequitable results”]; and *Cernocky v. Indem. Ins. Co. of N. Am.* (1966) 69 Ill. App.2d 196, 209, 216 N.E.2d 198, 205 [“The fact that no offer was made by Marquards to settle within the policy limits is merely one factor to be considered in light of the surrounding circumstances in determining whether the defendant was guilty of bad faith”].)

Although there are decisions to the contrary, it is evident that a number of courts have issued well-reasoned decisions holding that an insurer has an affirmative duty to settle. This duty, however, is based on the insurer’s duty of good faith and fair dealing. Where, as in California, the duty of good faith does not include an insurer’s duty to affirmatively engage in settlement, the practitioner must look elsewhere, and that elsewhere is in the insurance industry’s own assumption of a duty to settle claims, even when there is no settlement demand.

The insurance industry has assumed the duty to settle claims

A. The Assumption of Duties under California Law

California Courts have adopted Restatement (Second) of Torts § 323, which provides:

One who undertakes, gratuitously or for consideration, to render services to



another which he should recognize as necessary for the protection of the other's person or things, is subject to liability to the other for physical harm resulting from his failure to exercise care to perform his undertaking, if

- (a) his failure to exercise such care increases the risk of such harm, or
- (b) the harm is suffered because of the other's reliance upon the undertaking.

(Restatement [Second] of Torts § 323 [1965]; emphasis added)

The foregoing Restatement has long been applied by California Courts (See, e.g., *Artiglio v. Corning Incorporated* (1998) 18 Cal.4th 604, 613). In so doing, both California Courts and courts of other states have applied the Restatement to a wide range of activities performed by the insurance industry. (See *Cooper v. State Farm Mut. Ins. Co.* (2009) 177 Cal.App.4th 876 [insurer assumed duty to preserve evidence for its insured].)

A duty may be assumed to a class of individuals, and not just to a particular individual. Therefore, in *Brown v. Turner Const. Co., et al.* (2005) 127 Cal.App.4th 1334, the court held that a general contractor assumed a duty to protect "workers" at a construction site "from injuries due to falling." It is, therefore, not necessary that the party assuming the duty do so as to only a particular individual. Indeed, it is not even necessary that the injured party relied on the party that assumed the duty; it is only necessary that, once a party assumes a duty, it not "increase the risk of harm." It is submitted here that this is exactly what the insurance industry has done; the industry has assumed a duty to its policyholders, through its knowledge and conduct, to settle claims where there is no settlement demand. Having done so, the insurance industry cannot draw back from that duty, because to do so would increase the risk of harm to its policyholders for excess judgments.

B. The insurance industry has assumed the affirmative duty to settle

The insurance industry has long

recognized that an insurer must make affirmative efforts to settle claims, and not merely wait for demands. As pointed out by the International Risk Management Institute ("IRMI"), which provides underwriting, claims handling and policy interpretation information to the insurance industry, "Unless the claim is perceived to be utterly frivolous, the defendants and the insurer should consider approaching the plaintiff early in the litigation to try to achieve a settlement" (IRMI, Vol. I, IV.G.16). Likewise, in James Markham's insurance industry text book, *The Claims Environment*, the author points out that the claim representative should take the initiative in making settlement offers and not wait for a settlement demand to settle the case (Markham, James J. [Ed.], et al., *The Claims Environment* (Insurance Institute of America, 1st ed., 1993), pp. 260-261; and see Rokes, Willis Park, *Aggressive Good Faith and Successful Claims Handling* (IIA, 1st ed., 1987), p. 123, that an insurer has an affirmative duty to settle claims).

In addition to recognizing the duty to affirmatively settle claims, insurance companies have adopted specific claims handling programs and policies aimed at settling claims early and before any settlement demands have been made. For example, as early as 1991, State Farm adopted an early settlement program which involved making "offers on all appropriate files within thirty days of the initial assignment" (February 5, 1991, Memorandum from Leigh Murry, Claim Superintendent, to George Ellis, Divisional Claim Superintendent, p. 2). In another State Farm document entitled "Job Aspects for Claim Representatives," it is laid out that one aspect of the claims representative's job is to "[i]nitiate[] negotiations rather than react to demands," and that the adjuster will "[a]ttempt[] to settle for Specials in appropriate cases" (Id., p. 2).

More recently, State Farm, in its "Auto Claims Manual," set forth the following claim handling requirement:

The claim representative must constantly evaluate a claim with the ultimate goal of concluding that claim in a fair and reasonable manner. Current value is an established range of values for a file based upon all relevant information available to date. It focuses our claim handling on proper resolution of the claim.

Settlement should be attempted as soon as current value is established and necessary investigation complete. (State Farm Auto Claims Manual, pp. 9, 11)

GEICO, in its claims manual, also sets forth the adjuster's responsibility to settle claims as early as possible. According to the manual:

Every effort should be made to effect settlement as soon as sufficient information is secured to make a determination on liability and injury evaluation.

Prompt investigation is crucial. Remember; the real objective of investigation is a fair settlement at the earliest possible time.

As early as possible, the claims handler should convey to the claimant the Company's desire to reach a fair and equitable settlement.

A fair resolution of the claim at the earliest appropriate time should be one of the claims person's most compelling interests. Many claims can be settled on first contact.

(GEICO Claims Manual, pp. V2, V31-V32; emphasis in original)

Farmers has long had in effect early claim settlement programs, which are aimed at settling claims before any demand is made. In Farmers' "Liability Claims Strategy" publication, Farmers points out that, "[i]f the facts [of the claim] suggest we have a case for settlement, our efforts must be directed at obtaining only the necessary information to promptly evaluate and dispose of the claim" (Id., p. 1). Likewise in Farmers' "Liability Claims Strategies & File Documentation Standards" manual, Farmers provides guidance to its claims handlers on how to settle claims:



This is the phase where you offer money to resolve the injury claim. The settlement offer should be based on experience with similar injuries and the early settlement guidelines. To be successful with the early settlement, you must approach the process with the assumption that the Claimant will say yes to the offer. Confidence is of utmost importance (as with any negotiation). After extending an offer to settle, it is recommended that you stop talking. Continued conversation after the offer may indicate to the Claimant that you have little confidence in your offer. This is the point where the Claimant will accept the offer, ask more questions, talk additional dollars or reject the settlement attempt.

(*Id.*, p. 3)

The same Farmers documents set forth in detail the “Components of Early Settlement” within Farmers’ “In Person Contact Program” (“IPC”), including initial interaction with the claimant, discovery or investigation of the claim, evaluation of the claim, and finally the settlement of the claim (*Id.*, p. 2). Farmers’ efforts to obtain early settlements by making first settlement offers also extends to claims in which the claimant is represented by counsel (*Id.*, p. 7).

Recently, a New Mexico Appellate Court discussed the components of Farmers’ IPC and early settlement programs:

As part of its liability strategy and standards, Farmers requires that adjusters make early contact with claimants. Farmers also requires its adjusters to contact claimants by telephone within twenty-four to forty-eight hours on receiving a claim, and to set

up an early face-to-face meeting with the claimants. The practice of requiring claims adjusters to meet with claimants is referred to as the in-person contact program (IPC).

Another component of Farmers’ liability strategy and standards is the requirement that a certain percentage of unrepresented bodily injury claims be settled within sixty days for \$1,500 or less. This claims settlement practice is referred to as early claims settlement (ECS). Farmers provides adjusters with ECS objectives, advising adjusters that failure to meet those objectives could result in employee discipline.

Memoranda from Farmers to Sherrill indicate that in March 2010 Farmers’ expectation was that forty-eight percent of claims would be settled through the ECS program. . . . Sherrill testified that there were many claims that she was asked to settle under ECS for which the ECS guidelines would have resulted in unfair settlements.

(*Barbara Sherrill v. Farmers Ins. Exch.*, March 22, 2016, 2016 WL 1133873, ___ P3d ___, p. 2)

Nowhere in these, and similar documents, does the insurer tell its claims handlers to only settle claims when there is a settlement demand. Rather, the opposite is the case. Clearly, as the foregoing examples demonstrate, the insurance industry has assumed the duty to protect its policyholders in all cases by affirmatively making settlement offers before there is a settlement demand.

Conclusion

Practitioners should seek to have trial and appellate courts revisit an insurer’s duty to affirmatively engage in

settlement. This can be done by presenting evidence that apparently was not presented in either *Du* or *Reid*. That evidence would be the practice in the insurance industry of seeking to settle claims before there is a settlement demand. This evidence can be developed in deposition testimony of the insurance claims handlers, as well as from documents obtained in discovery from the insurer. Both sources are likely to reveal that an insurer has a policy of seeking to resolve claims as quickly as possible, which is best done by making early settlement offers. Based on this evidence, the practitioner can then argue that the individual insurer has assumed the duty to make affirmative settlement offers and cannot now back out of that duty. In so doing, the practitioner will close the narrow carve-out that the insurance industry has sought to create for its own interests.



Miller

Charles M. Miller’s practice has been devoted to insurance law since 1990. From 1972 to 1990, he was employed in the insurance industry, where he worked as an insurance claims representative and claims manager. Mr. Miller

has been retained in more than 15 states and territories, including Canada, as an expert on insurance industry practices and standards, as well as on various insurance policy coverage issues. He can be reached at cmiller.ilc@earthlink.net.

