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The evolving nature of the duty to settle

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AUGUST 2, 2019

Although the seminal decisions imposing a duty to settle on liability insurers are now a century old, the nature of the duty remains unsettled.

Insurers view the duty as an obligation to respond to settlement offers that does not arise until the claimant makes a formal settlement demand.

Policyholders, on the other hand, maintain that the duty requires insurers to attempt to effectuate settlement.

Under this view, the duty is an affirmative obligation that arises whenever the insurer's investigation reveals a likelihood of liability in excess of policy limits.

In this circumstance, the insurer must initiate settlement negotiations and may not sit back and wait for a demand from the claimant.

In recent months, the highest courts of two states addressed the nature of the duty to settle. Both adopted the insurance industry's view.

The Georgia Supreme Court did so expressly in language that leaves no room for argument. The Rhode Island Supreme Court did so obliquely in language that arguably leaves room for policyholders to argue that the question remains open in that state.

THE GEORGIA RULING

In *First Acceptance Insurance Co. of Georgia Inc. v. Hughes,* 826 S.E.2d 71 (Ga. 2019), the Georgia Supreme Court held that a liability insurer's duty to settle arises when the injured party presents a valid demand to settle within the insured's policy limits. An insurer breaches that duty only if it rejects a reasonable settlement demand.

The *Hughes* decision arose out of a multivehicle traffic accident caused by First Acceptance Insurance Company's insured, who died as the result of injuries he suffered in the accident.

The accident injured five individuals, including Julie An and her minor daughter Jina Hong. Hong sustained a fractured skull and bleeding on the brain, and she was in a coma for four to five days. An suffered a neck injury, and her arm was permanently scarred.

The insured's bodily injury liability limits of $25,000 per person and $50,000 per accident were insufficient to fully compensate all the injured parties. On Jan. 15, 2009, First Acceptance's attorney sent the injured parties' attorneys a letter proposing a joint settlement conference/mediation to resolve the claims.

> On June 2, 2009, an attorney who represented both An and Hong faxed two letters to First Acceptance.
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> In the first letter, the attorney stated his clients would be willing to settle their claims for the available policy limits. The letter requested insurance information described in the second letter.
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> In the second letter, the claimants requested that First Acceptance provide certain insurance information within 30 days. Neither letter explicitly referenced the other, and the first letter placed no time limit on An's and Hong's willingness to settle.

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First Acceptance's attorney reviewed both letters, after which they were inadvertently filed with some medical records. First Acceptance did not respond to the letters.

Then, on July 13, 2009, the attorney for An and Hong sent another letter in which he noted First Acceptance's failure to respond for 41 days and advised that the offer to settle had been revoked.

First Acceptance's attorney responded to the July 13 letter with a letter inviting the attorney and his clients to attend a settlement conference. An's and Hong's attorney declined to participate in the settlement conference.

On Feb. 19, 2010, First Acceptance offered to settle Hong's claim for the policy's $25,000 per person policy limit. On Sept. 24, 2010,

First Acceptance offered to settle both An's and Hong's claims for $25,000 each, exhausting the policy's full $50,000 per accident policy limit. Both offers were rejected. Hong and An proceeded with litigation against the insured's estate, which resulted in a jury award in excess of $5.3 million for Hong's injuries.

Following entry of the judgment, the administrator of the insured's estate sued First Acceptance for negligence and bad faith in failing to settle Hong's claim within the policy limits.

The trial court granted First Acceptance's motion for summary judgment. A state appeals court reversed, finding that issues of material fact existed as to whether the June 2, 2009, letters constituted a time-limited settlement offer and whether First Acceptance acted in bad faith in failing to accept it.

After granting certiorari, the Georgia Supreme Court reversed the appeals court and found that First Acceptance was entitled to summary judgment.

The Georgia high court first addressed a question it specifically asked the parties to brief: "whether an insurer's duty to settle arises only when the injured party presents a valid offer to settle within the insured's policy limits or whether, even absent such an offer, a duty arises when the insurer knows or reasonably should know that settlement within the insured's policy limits is possible."

As to this threshold issue, the court concluded that an insurer's duty to settle arises only when the injured party presents a valid offer to settle within the insured's policy limits.

In so ruling, the court pointed to "sound" policy reasons for making a written settlement demand a prerequisite to a liability insurer's duty to settle.

Without an offer within the policy limits, the only evidence of an essential element of the insured's case — that the insurer could have settled the case within the policy limits — will be after-the-fact testimony of the injured party that it would have settled within the policy limits.

Such testimony is, in the court's view, unreliable and often self-serving or the product of collusion between the insured and the injured party.

Accordingly, First Acceptance's liability depended on whether First Acceptance rejected a valid settlement offer within policy limits.

The court acknowledged that the June 2 letters constituted a valid offer to settle Hong's and An's claims. The issue was whether First Acceptance's nearly nine-month delay in accepting the June 2, 2009, offer was untimely and thus tantamount to a rejection.

The court held that the delay was not untimely because the June 2 letters were silent on the time allowed for acceptance. It therefore construed the offer to remain open for a reasonable time.

The court also commented on how the existence of multiple claims affects an insurer's duty to settle.

It did so when it rejected the plaintiff's argument that the jury should be allowed to consider whether a prudent insurer would have attempted to resolve the most serious claim facing the insured immediately rather than try to achieve a global settlement through mediation.

The court explained that an insurer may — but is not required to — settle a portion of claims when multiple claims exist.

THE RHODE ISLAND DECISION

The issue before the court in *Summit Insurance Co. v. Stricklett,* 199 A.3d 523 (R.I. 2019), was whether liability insurers owe third-party claimants a duty to settle.

The Rhode Island Supreme Court held that they do not, rejecting a common law right of third parties to sue liability insurers without first obtaining an assignment from the insured.

> The Rhode Island Supreme Court's decision in *Stricklett* arguably is more significant for what it implies about the elements of the duty to settle than for what it says about who has standing to sue.

That holding is not particularly consequential. In fact, it is the law in nearly every other jurisdiction.

What makes the *Stricklett* decision important is language in the opinion that arguably reinforces the requirement of a formal (or at least a written) settlement demand as an element of a bad-faith failure to settle a case in Rhode Island.

In *Stricklett,* a car operated by Summit Insurance Co. insured Eric Stricklett struck and injured Scott Alves, who was 11 years old at the time. Scott underwent three surgeries to repair a fractured tibia and fibula.

At the time of the accident, Summit insured Stricklett's vehicle under a policy with a $25,000-per-person coverage limit. Scott's medical bills alone totaled nearly three times the Summit policy's per-person limits.

After investigating, Summit determined that Stricklett was not at fault and informed the Alves family that it would "make no offers in this case."

The Alveses' attorney responded that the Alveses were "still in the process of pursuing this claim." Despite knowing Stricklett had only $25,000 in insurance to settle the claim, the attorney did not make a settlement demand on behalf of the Alveses.

Summit did not hear from the Alveses or their attorney for the next eight years. A new attorney contacted Summit less than a year before Scott would turn 21 and the limitations period would expire.

Invoking the Rhode Island Supreme Court's decision in *Asermely v. Allstate Insurance Co.*, 728 A.2d 461 (R.I. 1999), the attorney argued that because Summit had previously failed to offer its policy limit, the insurer was liable for all damages over and above the policy limit.

He made a settlement demand of $300,000. Summit responded by offering its $25,000 policy limit. The Alveses rejected the offer and sued Stricklett.

Summit thereafter sought a declaratory judgment establishing that its liability should the Alveses prevail in their lawsuit against Stricklett was limited to Stricklett's $25,000 policy limit. In opposition, the Alveses argued that *Asermely* created a duty of good faith and fair dealing on the part of an insurance company that runs to both insureds and to third-party claimants.

The Alveses maintained that their failure to make a settlement demand within the policy limits did not bar recovery. In their view, *Asermely* created a strict duty on the insurer to proactively engage in settlement discussions.

Although finding Summit did owe the Alveses a duty to act in good faith in settling their claim against Stricklett, the trial judge ruled that Summit fulfilled its duty. The court entered judgment for Summit, and the Alveses appealed.

The Rhode Island Supreme Court affirmed, albeit on different grounds. In contrast to the trial court, the Supreme Court flatly rejected the Alveses' argument that Summit owed them a duty of good faith and fair dealing in settlement negotiations.

The court explained that an insurer's duty to settle arises from the "contractual, fiduciary" duty between an insurer and its insured.

The court previously had ruled in *Auclair v. Nationwide Mutual Insurance Co.*, 505 A.2d 431 (R.I. 1986), that the relationship between an insurer and a third party is adversarial, "giving rise to no fiduciary obligation on the part of such insurance carrier to the claimant."

In *Summit*, the court held that the inherently adversarial relationship between the Alveses and Summit precluded recognition of a settlement duty flowing from Summit to the Alveses.

The court acknowledged that third-party claimants successfully sued liability insurers for extracontractual damages in *Asermely* and in *DeMarco v. Travelers Insurance Co.*, 26 A.3d 585 (R.I. 2011), but it emphasized that they did so as assignees of the insured tortfeasors. As such, they were enforcing the insured's rights rather than their own.

The court emphasized that the assignments in *Asermely* and *DeMarco* were a sine qua non of the claimants' recovery, not an extraneous fact that "just so happened" to be present, as the Alveses argued in the trial court.

READING THE TEA LEAVES

Stricklett arguably is more significant for what it implies about the elements of the duty to settle than for what it says about who has standing to sue.

The *Stricklett* court chastised the plaintiffs for taking language from the court's previous opinions in *Asermely* and *DeMarco* out of context without regard to other language in those opinions or what the court actually ruled.

> Although the *Hughes* and *Stricklett* decisions were met with cheers in the insurance industry and caused consternation among plaintiff attorneys, they do not represent a clear trend in the law.

The court's extended discussion of its jurisprudence on the nature of an insurer's fiduciary duty to settle suggests that it was concerned that this practice extends beyond the narrow issue of whether liability insurers owe a direct duty to third-party claimants.

For example, in *Asermely*, the court explained that an insurer's "fiduciary obligation to act in the 'best interests of its insured in order to protect the insured from excess liability'" arises only if the insurer "has been afforded reasonable notice and if a plaintiff has made a reasonable written offer to a defendant's insurer to settle within policy limits." 728 A.2d at 464 (citations omitted).

Only then does the insurer's duty "to seriously consider such an offer" arise. *Id.*

Notwithstanding *Asermely's* unequivocal requirement of a written settlement offer, some have argued that the court overruled this aspect of *Asermely* sub silentio in *Skaling v. Aetna Insurance Co.*, 799 A.2d 997 (R.I. 2002).

In *Skaling*, the court characterized a liability insurer's settlement duty as "an affirmative duty to engage in timely and meaningful settlement negotiations and to make and

consider offers of settlement consistent with an insurer's fiduciary duty to protect its insured from excess liability." 799 A.2d at 1011.

Policyholders have focused on this language in arguing that when liability is clear and damages are substantial, an insurer cannot sit back and wait for the claimant to make a settlement demand but must initiate settlement negotiations.

However, the issue of what triggers the duty to negotiate was not before the court in *Skaling*, and the court did not address it.

Skaling was a dispute over underinsured motorist benefits. The court discussed a liability insurer's duty to settle solely for the purpose of reconciling that duty with an insurance company's right to contest "fairly debatable" first-party claims.

The *Summit* opinion clarified that a formal settlement demand remains a prerequisite to a liability insurer's duty to settle.

The court not only quoted the language in *Asermely* with approval but italicized the language for special emphasis. 199 A.3d at 529.

More to the point, the court noted that even were it to impose on Summit a direct duty to the Alveses, the absence of an offer to settle within policy limits would have precluded recovery. 199 A.3d at 532.

CONCLUSION

Although the *Hughes* and *Stricklett* decisions were met with cheers in the insurance industry and caused consternation among plaintiff attorneys, they do not represent a clear trend in the law.

Courts remain divided on the question of whether and when a liability insurer has a duty to initiate settlement negotiations.

In fact, late last year, just months before the *Hughes* and *Stricklett* decisions were issued, the case law appeared to be heading in a pro-policyholder direction. See John K. DiMugno, *Harvey and the quasi-fiduciary duty to settle*, WESTLAW J. INS. COVERAGE (Nov. 2, 2018).

This article first appeared in the August 2, 2019, edition of Westlaw Journal Insurance Coverage.

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