What’s an Insurer to Do?

By Jonathan M. Stern

Competing claims for insurance-funded settlements are likely to be made with threats of bad faith to come.

Multiple Claims and Insufficient Limits

A single occurrence causes multiple bodily injuries, multiple instances of property damage, or both. Numerous claims are made, liability is reasonably clear, and the fair value of these claims far exceeds the available insurance limits of liability. What’s an insurer to do?

Given the wide recognition of an action for bad faith failure to settle (e.g., Voccio v. Reliance Ins. Cos., 703 F.2d 1, 2 (1st Cir. 1983) (“Most ‘bad faith’ cases involve an insurance company’s refusal to accept an offer of settlement within the available policy limits.”)), insurers are likely to be confronted with a damned if you don’t, damned if you do dichotomy. See 2-5A The Law of Liability Insurance §5A.13 (Matthew Bender & Co. 2009) (describing it as a “perplexing dilemma” and discuss-
ing various approaches to the problem). Many states’ unfair claims settlement practices laws prohibit insurers from “[n]ot attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear.” Claimants desirous of a quick settlement (and they are more likely to be when available insurance limits are insufficient to satisfy all claims) likely will use short-deadline demands to pressure insurers to settle or face bad faith claims for failure to do so. Others will insist that it would be an act of the utmost bad faith, for which a suit would follow, for the insurer to settle any claims and thereby diminish the funds available to satisfy prospective judgments. The result is that the insurer is whipsawed between competing claimants, all threatening an endless supply of lawsuits for bad faith.

**The Insurer’s Obligations**

Depending on the jurisdiction whose law applies, the insurer’s obligations vary. Most jurisdictions subscribe to the view that the insurer may settle fewer than all of the claims regardless of the fact that claims will remain when the insurance proceeds are exhausted. 4-21 The Law of Liability Insurance $21.02 (Matthew Bender & Co. 2009); e.g., Miller v. Georgia Interlocal Risk Management Agency, 501 S.E.2d 589 (Ga. App. 1998). Most of these courts have noted that, “in the absence of a claim of bad faith, the permissibility of the settlement of one claim leaving another potentially excess claim open could not be questioned.” E.g., State Farm Mut. Auto. Ins. Co. v. Murphy, 348 N.E.2d 491, 494 (Ill. App. Ct. 2d Dist. 1976); Liguori v. Allstate Ins. Co., 184 A.2d 12, 16 (N.J. Super. Ch. Div. 1962); Alford v. Textile Ins. Co., 103 S.E.2d 8, 13 (N.C. 1958). Others hold the insurer to a higher standard, requiring it to seek to maximize the benefit to the insured for each dollar of insurance money expended in settlement.

Under Florida law, for example, an insurer has three obligations in this scenario. Farinas v. Florida Farm Bureau Gen. Ins. Co., 850 So. 2d 555 (Fla. Dist. Ct. App. 4th Dist. 2003), reh’g and reh’g en banc denied and question certified (Jul. 9, 2003), rev. denied, 871 So. 2d 872 (Fla. 2004). First, the insurer is required to “fully investigate all the claims at hand to determine how to best limit the insured’s liability.” 850 So. 2d at 560. An insurer does have some “discretion in how it elects to settle claims, and may even choose to settle certain claims to the exclusion of others, provided this decision is reasonable and in keeping with its good faith duty.” Id. at 561. Second, the insurer should seek “to settle as many claims as possible within the policy limits.” Id. at 560; accord Peckham v. Continental Cas. Ins. Co., 895 F.2d 830, 835 (1st Cir. 1990). Third, the insurer has a “duty to avoid indiscriminately settling selected claims and leaving the insured at risk of excess judgments that could have been minimized by wiser settlement practice.” 850 So. 2d at 560. Whether these duties have been breached is a jury question. Id. The Farinas court held that it was for a jury to decide whether the insurer’s failure to pursue global and other settlement options was in the insured’s best interests, whether the insurer’s quick settlement with three claimants was reasonable, and whether the insurer investigated the facts of all the claims. Id. at 561; accord Dadeland Depot, Inc. v. St. Paul Fire & Marine Ins. Co., 483 F.3d 1265 (11th Cir. 2007). Lest one think that these requirements are of recent concoction or limited to Florida, the Second Circuit, applying New York law, reached a similar conclusion in 1963 in Brown v. United States Fidelity & Guaranty Co., 314 F.2d 675 (2d Cir. 1963), and the Fifth Circuit, applying Florida law, reached a similar conclusion in 1969 in Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475 (5th Cir. 1969).

Most of the published cases leave open the possibility that exhaustion of a policy’s limits through one or more settlements entered in bad faith (e.g., with the clear purpose of discontinuing the provision of defense by paying more than necessary in order to exhaust limits of liability) could expose the insurer to excess liability. For example, although the Supreme Court of Texas in Texas Farmers Ins. Co. v. Soriano, 881 S.W.2d 312 (Tex. 1994), ruled that the insurer was not liable for the excess judgment, it framed the question and answer with respect to evidence of bad faith, not a hard-and-fast rule:

The issue in this case is whether there is any evidence that the Texas Farmers Insurance Company was negligent or breached a duty of good faith and fair dealing in failing to settle certain claims against its insured, Richard Soriano. We hold there is no evidence of negligence or bad faith.

Soriano, 881 S.W.2d at 313. It did, however, also rule that, “when faced with a settlement demand arising out of multiple claims and inadequate proceeds, an insurer may enter into a reasonable settlement with one of the several claimants even though such settlement exhausts or diminishes the proceeds available to satisfy other claims. Such an approach, we believe, promotes settlement of lawsuits and encourages claimants to make their claims promptly.” Id. at 315 (footnote omitted). The word “reasonable” may be important insofar as an “unreasonable” settlement that exhausts a policy with other claims unresolved might be held in Texas to expose the insurer to liability in excess of policy limits.

Cases recognizing these duties of an insurer typically conclude that there is no evidence of bad faith (and thus grant summary judgment to the insurer) or hold that a jury question is presented. One case in which the court decided as a matter of law that the insurer had acted in bad faith and, therefore, that an adverse summary judgment for liability in excess of the policy’s limit of liability was warranted is DeMarco v. Travelers Ins. Co., No. PC 2006-6103, 2008 R.I. Super. LEXIS 125 (R.I. Super. 2008). Describing the facts before it as unique, the court explained:

[T]he legal analysis and fact questions relevant to an insurer’s obligations in multi-claimant cases are beside the point. It is undisputed that Travelers did not attempt to negotiate any of the claims until days before the DeMarco trial was locked on to begin and, instead, refused to consider all of the three claimants’ settlement offers, relying on the claimants to negotiate their claims vis-à-vis each other and reach a global settlement within the policy limits. Furthermore,
Travelers refused to make any unconditional individual settlements until after the DeMarco claim had been reduced to a judgment, and the insured’s liability on it and the accumulated interest had attached. It was only then that Travelers settled one of the claims and, therefore, questions concerning its use of professional skill and good faith in selecting which of the multiple claims should be settled in order to “relieve its insured of so much of his or her potential liability as is reasonably possible” are extraneous in the context of the narrow circumstances of this case. As far as its strategy went, Travelers well may have been acting within the technical meaning of its policy provisions when it refused to consider any settlement offers and invited DeMarco to prove his damages at trial, but it also assumed the consequences of its decision to stand firm on those rights.  

Id. at *25–26.

**Interpleader Typically Is Not a Good Answer**

Many practitioners confronted with the insurer’s predicament in this scenario advocate the use of interpleader, a procedure by which the amount of money representing the policy’s limits of liability is deposited with a court and the competing claimants are joined as defendants to present their competing claims to the pot. The prototypical interpleader situation is where there is a fixed amount owed by the insurer but uncertainty as to whom it should be paid (e.g., a life insurance policy with competing claimants). While there are cases in which liability policy limits have successfully been interpled, many states limit such practice. Interpleader in cases of third-party liability insurance proceeds is more likely to be successfully invoked in cases of defunct, dead, or bankrupt insureds.

One reason that insurers may consider interpleading their limits is the belief that doing so will bring their duty to defend to an end, preclude any chance of being held to have acted in bad faith, or both. While most courts agree that the insurer’s duty to defend ends upon the exhaustion of policy limits, the exhaustion must be in accord with the policy terms—typically “by payment of judgments or settlements.” E.g., Barry R. Ostrager and Thomas R. Newman, Handbook on Insurance Coverage Disputes §5.03[a] (14th ed. 2008). The duty to defend typically does not terminate when the limits are exhausted by other means, such as interpleader, payment under an “advanced payment program” to the claimants, or payment to the insured. See, e.g., Emcasco Ins. Co. v. Davis, 753 F. Supp. 1458, 1461 (W.D. Ark. 1990) (“The insurance carrier’s contract does not by its terms permit it to artificially exhaust the limits of liability by paying them into the registry of the court and walking away, leaving the insured without the carrier’s assistance to accomplish all of those things that they rightfully thought that they had hired the insurance company to do for them.”); Ostrager §5.03[a]. Therefore, it is likely that the duty to defend would not terminate upon interpleader of policy limits with a court. See, e.g., Charles Alan Wright, Arthur R. Miller, and Mary Kay Kane, Federal Practice and Procedure: Civil 3d §1713 (2001).

The act of interpleading does, perhaps, prevent anyone from successfully claiming that the insurer was unwilling to pay the full amount of its coverage. See Monumental Life Ins. Co. v. Lyons-Neder, 140 F. Supp. 2d 1265, 1270 (N.D. Ala. 2001) (“Because filing an interpleader action is equivalent to the plaintiff’s admitting that it is willing to pay the legitimate claimant, an interpleading stakeholder cannot logically be subjected to a claim alleging bad faith refusal to pay…. “); Texas Farmers Ins. Co. v. Soriano, 844 S.W.2d 808, 833 (Tex. App. 1992) (concurring op.) (“Even though interpleading of the funds would not discharge the carrier of its responsibility to provide a defense and otherwise remain involved until the disposition of the claims, it would certainly be per se evidence of good faith intentions and would negate any inference that the carrier was trying to increase its profits by not paying the full amount of coverage.”), rev’d on other grounds, 881 S.W.2d 312 (Tex. 1994). Yet, the same result can be achieved with an early offer to pay policy limits to achieve a global settlement.

More importantly, interpleader arguably constitutes an abdication of the insurer’s responsibility to prudently manage the policy to remove as much exposure as possible from the insured. Once the money is interpled, it likely is inaccessi-
ple claims and insufficient proceeds]. It accomplishes nothing at all unless there is a settlement or a trial, because the claimants are claiming more than the interpled fund. Interpleader does not settle the various tort cases unless all claimants agree on how to distribute the limited funds. And certainly the court could not deny litigants a jury trial and parcel out the interpled insurance coverage without a settlement agreement. The claimants have a right not to take the limited insurance money, but instead to take an excess judgment against the insured and try to collect it. Unless there is a settlement, interpleading the policy limits into court simply does not change the fact that there would have to be a trial. The general rule is that after such a trial the court should distribute the limited funds proportionately among the claimants, according to the percentage of damages suffered in comparison to the whole. Nevertheless, after such a pro rata distribution, the insured would still face several excess judgments instead of one, as in the present case. An insurer that interpled its policy limits in a multiple claimant case, as the majority recommends, was held liable for an excess judgment in Farmers Insurance Exchange v. Schropp, 222 Kan. 612, 567 P.2d 1359 (Kan. 1977). Interpleader merely passes the buck from the insurer to the court and provides little protection for the insured."

Soriano, 844 S.W.2d at 843 (dissenting opinion).

The act of interpleading the policy limits may not provide any real benefit to the insurers. It probably will not immunize insurers from any bad faith that exists before the money is interpled. See Mendez v. Teachers Ins. & Annuity Ass’n & College Retirement Equities Fund, 982 F.2d 783 (2d Cir. 1992) (holding insurer liable for bad faith for delaying the filing of the interpleader). It also may not preclude a finding of bad faith subsequent to the interpleader. See, e.g., Allstate Ins. Co. v. Johnson, 1993 U.S. Dist. LEXIS 8740 (E.D. Pa. 1993) (“Allstate asks the court to declare that its liability to indemnify its insured is limited to the amount of coverage under the applicable automobile insurance policy. The court cannot do that, because it depends in part on Allstate’s continued good faith representation of its insureds in the underlying lawsuit now in progress.”). And it may not immunize the insurer from any bad faith inherent in its institution of the interpleader proceeding. Prudential Ins. Co. of Am. v. Hovis, 553 F.3d 258 (3d Cir. 2009); Kelly v. Farmers Ins. Exchange, 194 Cal. App. 3d 1, 9 (Cal. App. 1st Dist. 1987).

No case we have found has held that a liability insurer acted in bad faith by interpleading its policy limits. To the contrary, the few cases on this point we have found have held in favor of insurers facing similar claims. See Schwartz v. State Farm Fire & Casualty Co., 88 Cal. App. 4th 1329 (Cal. App. 2d Dist. 2001), and Lehto v. Allstate Ins. Co., 31 Cal. App. 4th 60 (Cal. App. 2d Dist. 1994) (both holding that an insurer’s interpleader of policy limits did not or would not constitute an act of bad faith); Bowers v. State Farm Mut. Auto. Ins. Co., 460 So. 2d 1288, 1290 (Ala. 1984) (unsure motorist claim) (“[A]bsent some evidence to the contrary, the mere filing of an action of interpleader does not amount to evidence of bad faith dealing on its part. But see Araiza-Klier v. Teachers Ins. & Annuity Ass’n of Am., 2004 Cal. App. Unpub. LEXIS 4381 (April 29, 2004) (holding insurer’s initiation of interpleader action could be one factor establishing the bad faith required to award attorney’s fees under ERISA); Farmers Ins. Exchange v. Schropp, 567 P.2d 1359 (Kan. 1977) (holding insurer who interpled limits liable for excess judgment but not tying the liability to the decision to interplead). Our belief that interpleading in this scenario could bring a viable bad faith claim is based on logic and anecdote. Anecdotally, we hear of insureds suing their insurers for interpleding funds that could otherwise be used to reduce potential liabilities at a discount. From a logical perspective, the decision to interplead would be for the insurers’ benefit. There is no real benefit to the insured when the insurer interpleads the policy limits. The insureds have no interest in who gets the insurance proceeds if their total liability is not thereby reduced. Because the insured’s total liability could be reduced by entering into prudent settlements of some of the claims, the interpleader—which likely will prevent subsequent settlements that do not resolve all claims—may be a detriment to interplead the policy limits. For example, if all efforts at settlement are unsuccessful and the cases are going to mature to judgment at about the same time, it may make sense to interplead the limits to achieve an equitable distribution. See, e.g., National Union Fire Ins. Co. v. Coric, 924 F. Supp. 373 (N.D.N.Y. 1996).

The Right Answer

Our view is that insurers should seek to maximize the insured’s bang for the settlement buck but that the insurer should be protected from liability under something in the nature of the business judgment rule that applies to corporate directors. See, e.g., Peckham v. Continental Cas. Ins. Co., 895 F.2d 830, 835 (1st Cir. 1990) (“So long as it acts in good faith, the insurer is not held to standards of omniscience or perfection; it has leeway to use, and should consistently employ, its honest business judgment.”); Liberty Mut. Ins. Co. v. Davis, 412 F.2d 475, 481 (5th Cir. 1969) (“Considerable leeway, of course, must be made for the insurer’s honest business judgment, short of mismanagement tantamount to bad faith.”). Thus, an insurer that has demonstrated its willingness to pay its full limits of liability to resolve claims against one or more insureds should not be second-guessed for the exercise of its judgment in settling claims. In such a case, there should be a...
presumption that the insurer acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the insureds. Extra-contractual liability should be reserved for cases in which the insurer proves that the insurer was grossly negligent or acted with actual bad faith in discharging its duties to its insured.

**Insurers should seek to maximize the insured’s bang for the settlement buck but . . . the insurer should be protected from liability under something in the nature of the business judgment rule.**

The insured, obviously, is best protected if all of the claims can be settled within the limits of liability of the policy. Therefore, before resorting to individual settlements, the insurer should engage the claimants in an effort to achieve a global settlement. The First Circuit in *Vocci v. Reliance Ins. Cos.*, 703 F.2d 1 (1st Cir. 1983), found the fact that “the carrier met together with counsel for both [claimants] and sought suggestions on how to divide the money” was evidence of the insurer’s good faith. *Id.* at 3. The effort to assemble a global settlement is widely supported in the case law. See, e.g., *Kinder v. Western Pioneer Ins. Co.*, 231 Cal. App. 2d 894, 902 (1965); *Bartlett v. Travelers Ins. Co.*, 167 A. 180, 184 (Conn. 1933). If this effort proves unsuccessful, the insurer must resort to “Plan B.”

While the law varies from state to state, the general rule is that the insurer must assess settlement opportunities as though it alone would be responsible for any judgment irrespective of its limits of liability. E.g., *Brown v. United States Fidelity & Guaranty Co.*, 314 F.2d 675, 678 (2d Cir. 1963). This approach, then, requires the insurer to act in good faith for the protection of its insured’s assets. Claims with $100,000 of available coverage, for example, should be evaluated no differently from claims with $1 billion in coverage (except perhaps that insurers should err on the side of caution with the smaller policies given the greater difficulty they may have in proving they acted disinterestedly).

The law with respect to how an insurer should handle the multiple claim excess exposure scenario is not well developed in most jurisdictions. A synthesis of the case law suggests that the insurer should exercise good judgment to best protect the insured’s assets, what we described above as getting the most bang for the buck. The following steps can be prudent ones to take to act in, and to make a record that the insurer is acting in, “good faith”:

1. The insurer should keep the insureds informed about the case(s) and about all settlement opportunities. A common complaint in bad faith litigation is that the insurer failed to apprise the insured of settlement opportunities.
2. The insurer should gather the information necessary to make informed decisions respecting settlement. This can include obtaining case evaluations from defense counsel or from a third party and obtaining defense counsel reports on the defensibility of the case and the likelihood of an adverse judgment.
3. The insurer should seek a global settlement where the available limits of liability are used to settle all of the claims. This can be accomplished through individual negotiations or by advising the claimants that the insurer is prepared to pay its limits if the claimants can agree on a division of those limits to settle all of the claims.
4. If the insurer is prepared to pay its limits to settle the cases and a global settlement proves unattainable, it can offer the insured control of the available limits to settle cases as it deems fit. This can transfer the responsibility for exercising good judgment to the insured, which presumably will seek to minimize its uninsured loss. This approach would provide clear evidence that no attempt was made to place the insurers’ interests ahead of the insureds. The approach, however, is complicated when there are multiple insureds, whether as named insureds or omnibus insureds. In such a case, the approach may be for the insurer to offer control to the insureds if and only if they can reach unanimous agreement on what to do with the money. Moreover, the insureds may refuse to take control of the money for settlement.
5. If control of the policy limits is not turned over to the insureds, the insurer should solicit their input on how to handle settlement opportunities. If the input received is not followed, the insurer must be prepared to articulate reasons for following a different course of action.
6. The insurer should not unfairly favor one insured over another. In most jurisdictions, an omnibus insured will have as much right to protection as a named insured. This can become an issue if there are separate suits against separate insureds and they are not settled as a group. If there are good justifications for such settlements, the reasons should be documented.
7. The insurer should engage separate counsel to advise it. In addition to helping sort out the law and determining what is required based on the involved jurisdictions, an advice of counsel defense may—in some cases—be appropriate.
8. The insurer should carefully consider the advisability or inadvisability of interpleader.
9. The insurer should document everything. This should include the conveyance of information to the insureds, confirmation of input received, and reasons for the approach ultimately followed. Memories fade quickly and memos to the file should be used generously in cases of this type. At the end of the day, the most important thing for the insurer will be the ability to convincingly articulate a reasoned basis for each step along the way.

**Conclusion**

The multiple claims and insufficient limits scenario is a difficult one for the insurer. Competing claims for insurance-funded settlements are likely to be made with threats of bad faith claims to come. The insurer is sure to be pushed and pulled in all directions. But there are logical steps to take to best protect the insureds and, at the same time, avoid—or be well-positioned to defend—claims of bad faith.