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RISK BITES

Disputes Over Settling Claims in Excess of Limits: An "Ethical" Strategy for Policyholders

By Mark Garbowski

Liability insurance policies routinely provide that the insurance company has the right to control the defense of the policyholder, including the right to control the settlement of the underlying claim. Such provisions are common in nearly all liability policies, including general commercial liability policies, automobile policies, professional liability policies, and Directors and Officers liability policies.

In theory, and in the best of conditions, the insurance company and the policyholder have parallel interests in the quick and efficient resolution of claims, including settlement. In theory, the policyholder's interests are adequately served by such an arrangement, because insurance companies have a fiduciary duty to their policyholders, including a duty of good faith and fair dealing in connection with their obligations. Moreover, the defense counsel hired by the insurance company also has an independent duty to represent the policyholder's interest.

In practice, however, a policyholder often must remind its insurance company of these obligations.

Types of Disputes and Insurance Company Reimbursement

The policyholder and the insurance company can disagree over what constitutes a reasonable settlement. These disagreements can cause tension to develop between the policyholder and its insurance company, especially where this disagreement is combined with an additional factor, such as (1) a separate dispute over the selection of defense counsel; (2) a separate dispute over whether all or part of the claims are covered; or (3) when the policyholder is exposed to liability in excess of the policy limits.

Right now, there is considerable attention being focused on the second category, due to the Texas Supreme Court's recent ruling in what is commonly known as the *Frank's Casing* case, in which an excess liability insurance company sued its policyholder for reimbursement of funds paid as part of a settlement. The court held that an excess insurance carrier that disputed coverage but funded a settlement of third-party claims against its policyholder can attempt to recoup the settlement payments from its policyholder in a subsequent litigation seeking a "no coverage" determination. That decision is currently under reconsideration that might reverse or clarify the decision.

Claim Exceeds Limits, Settlement Does Not

This article will focus, however, on the third category of disputes. Even when there is no dispute that the claim is covered by the insurance policy, the policyholder may still be exposed because the claim or claims seek damages in excess of the limits of the policy. This can occur when either a single claim seeks damages in excess of the policy limits or when multiple claims have an aggregate exposure in excess of the policy limits. A conflict may arise if the claimant makes a settlement offer that is within the existing limits of the policy. The policyholder will usually want to settle the case within those limits to avoid the exposure in excess of the limits. The insurance company, however, has little to gain by the settlement and, therefore, may want to litigate the claim.

In these situations, the insurance company will generally assert the right to control the defense and settlement of the claim. However, when it does so, the insurance company still has the duty of good faith and fair dealing. These duties generally have been interpreted to mean that an insurance company cannot refuse a reasonable settlement offer when to do so would expose the policyholder to liability for the amounts in excess of the policy limits. If the insurance company does refuse a settlement offer within policy limits, and the plaintiff obtains a judgment in excess of those limits, the insurance company might be liable for the entire judgment.

Many policyholders are aware of these strategies, as are most plaintiff lawyers, and as a result, such situations have become common. Claimants often offer to settle within limits when the total claim exceeds limits, hoping to pressure the insurance company into agreeing to settle. *Frank's Casing* might cause policyholders to rethink their strategy, as the prospect that the insurance company might agree to settle, only to litigate coverage afterwards, makes this strategy less appealing.

The "Ethical" Approach

Policyholders therefore need to consider new approaches and strategies to induce their insurance companies not only to agree to settle, but also to waive their possible right to seek reimbursement afterwards. One potentially rewarding approach could be to focus on the fiduciary and ethical obligations of both the insurance company, and their appointed defense counsel.

In a little noticed ethics opinion published more than 10 years ago, the Massachusetts Bar Association determined that insurance companies cannot rely upon the analyses of assigned counsel to determine whether or not a proposed settlement is reasonable where the potential claim value exceeds the policy limits.

As explained by the Bar Association, "Where the claim exceeds the policy limits, and where the attorney knows or has strong reason to believe that the case can be settled within the policy limits, the insured's interest normally lies in convincing the insurer to settle for any amount up to the policy limit, and the insured will want its counsel to advocate that position as aggressively and persuasively as possible. The insurer's interest, however, is in paying the least amount possible. … When the attorney is requested by the carrier to provide a professional opinion as to the merits of the claim or its value for settlement purposes, the attorney cannot even begin to consider the matter objectively without adversely affecting the attorney's obligation to the insured to settle the case for any amount up to the policy limit."

In effect, the assigned counsel cannot ethically advise the insurance company of whether a potential settlement within limits is reasonable. Moreover, it is reasonable to conclude that the insurance company cannot, in good faith to its policyholder, rely upon such advice even if it is provided. Similarly, some courts have ruled that an insurance company cannot rely upon counsel who are too-closely tied to the insurance company for such advice, even without a conflict. Ultimately, a policyholder has a good faith basis for arguing that its insurance company must hire separate independent counsel if it is going to decide not to settle a claim, whenever that claim's full potential value exceeds the limits of the policy.

Conclusion

This approach offers at least a couple of benefits to the policyholder. First, and most directly, it simply makes it more expensive and more complicated for the insurance company to decide not to settle the claim. Second, it returns to the policyholder a bit of the leverage it might lose if *Frank's Casing* becomes the norm. A policyholder might agree to drop its demand that the insurance company hire additional, independent counsel if the insurance company (1) agrees to settle, and (2) agrees not to seek reimbursement later.

For this to work, however, policyholders must determine the relevant ethical norms in their jurisdiction, and if necessary, push things along. There is some, but not much, reported law on these points. Policyholders might need to be a bit aggressive in developing this area of the law, just as insurance companies are in developing law that helps them.

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