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Extent of Insurer's Duty to Start Settlement Discussions

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A three-judge panel of the United States Court of Appeals for the Tenth Circuit has held that while a primary insurer may owe its insured a duty to initiate settlement discussions under Oklahoma law, that duty does not extend to an excess insurer prior to exhaustion of the underlying coverage. *SRM Inc. v. Great American Insurance Co.*, No. 5:11-CV-01090-F (10th Cir. Aug. 25, 2015). In so holding, the Tenth Circuit highlighted just what a primary insurer is expected to do with respect to investigating and defending a claim against its insured.

After a train collided with a dump truck, killing the truck driver and causing the train to derail, three train workers sued the trucking company and its primary auto liability insurer, as well as the railroad. The railroad and the trucking company then asserted cross claims against each other. In addition to its primary insurer, the trucking company notified its excess insurers of the claim. The excess insurer proceeded to monitor the case for potential exposure under its umbrella policy.

A year into the primary insurer's defense of the trucking company and without a settlement offer from the claimants, an attorney obtained separately by the trucking company demanded that the primary insurer and the excess insurer tender their liability policy limits, \$1 million and \$5 million respectively, to settle the case. The primary carrier responded that it was prepared to offer its limit to the railroad to settle that claim or tender its limit to the trucking company and the excess carrier for their use in negotiating a settlement with the railroad and/or other claimants. The excess carrier, however, declined and instead "urged an aggressive defense." After losing its cross-claim and what it believed to be its best defense on pretrial

Authors

Nicole Audet Richardson
Consulting Counsel
202.719.3746
nrichardson@wiley.law

Practice Areas

Insurance

motions, the trucking company renewed its demand that the insurers tender their policy limits to settle. The excess insurer again declined that request, contending that it required additional discovery to properly evaluate the claims.

The parties subsequently agreed to mediation. At the time, defense counsel for the trucking company estimated the insured's potential exposure to be between \$4 million to \$7 million. The excess insurer estimated economic damages at approximately \$8 million, but believed that a likely jury award would be between \$2 million and \$4.65 million. The claimants initially demanded \$20 million at the mediation, but later agreed to settle for \$6.5 million. The settlement was funded by \$1 million from the primary carrier and \$5 million from the excess insurer. The trucking company paid the remaining \$500,000.

The trucking company then brought suit against the excess insurer, contending that the excess insurer breached the parties' insurance contract and the implied covenant of good faith and fair dealing by failing to proactively investigate the claims, failing to initiate settlement negotiations and forcing the trucking company to pay \$500,000 out-of-pocket to settle. The district court granted the excess insurer's summary judgment motion, concluding that the excess insurer did not owe the trucking company those claimed duties until the primary carrier tendered its policy limits at the time of settlement. The court also rejected the trucking company's motion for reconsideration based on an independent duty of good faith and fair dealing apart from contractual obligations.

On appeal from the entry of summary judgment in favor of the insurer, the Tenth Circuit explained that while Oklahoma law makes clear the implied duty of a primary insurer to "initiate settlement negotiations" if "an insured's liability is clear and injuries of a claimant are so severe that a judgment in excess of policy limits is likely," Oklahoma courts have yet to decide how this duty applies to an excess insurer whose contractual duties to its insured are not triggered until the primary insurer's policy limits have been exhausted. The court then proceeded to predict how the Oklahoma Supreme Court would decide the question. In doing so, the court focused on the language of the contract and concluded that the excess policy was unambiguous in providing that the excess insurer's contractual duties to investigate, settle or defend claims against its insured did not kick in until the primary insurer exhausted its policy limits by actually paying claims. In this regard, the court found that exhaustion did not occur here until both insurers simultaneously paid their respective limits at settlement. In other words, according to the court, at the same time the excess insurer's contractual duties to the trucking company took effect, those duties were fully discharged by paying its policy limits towards settlement.

In upholding the judgment in favor of the insurer, the court rejected the trucking company's efforts to "sidestep the policy it agreed to" by suggesting that the duty of good faith and fair dealing is an implied duty, independent of the policy language, applied equally to all insurers. Instead, the court explained that excess insurers have "a reasonable economic expectation" and it would be inappropriate for a court "to alter [those] obligations and economic expectations, which are rooted in the unambiguous terms of its contract with [its insured]." The court noted, however, that a key factor in its conclusion was that the claimants made no settlement offers or demands until the mediation, nor did the primary insurer negotiate a settlement that the excess insurer refused to join; rather, the demand came from the insured's separately retained counsel.

Had the primary carrier been in the hot seat, it appears that the court would have analyzed the claim differently. Citing Oklahoma case law, the Tenth Circuit acknowledged that “[i]n performing its contractual obligations a primary insurer owes its insured a duty of good faith and fair dealing,” which includes “an affirmative duty to initiate settlement negotiations’ if ‘an insured’s liability is clear and injuries of a claimant are so severe that a judgment in excess of policy limits is likely.’” The court added that any settlement decision must be “based on a thorough investigation of the underlying circumstances of the claim.” Here, the court provides a glimpse as to the degree of consideration a primary insurer is expected to exercise toward its insured in order to avoid a claim for bad faith. In this regard, it appears that the duty goes beyond a requirement simply to not refuse unconditional settlement offers within a primary insurer’s policy limits.