American Educational Institute, Inc.

CLAIMS LAW UPDATE

A SUPPLEMENT TO CLAIMS LAW COURSES IN CASUALTY, PROPERTY, WORKERS COMPENSATION, FRAUD INVESTIGATION AND AUTOMOBILE

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AEI CLAIMS LAW QUIZ

IS A FIRM SETTLEMENT OFFER A BAD FAITH PREREQUISITE?

[Good Faith Claims Handling, Para. 4.03]

FACTS: The underlying case involved an automobile accident that occurred in Louisiana. Danny Kelly and Henry Thomas were driving in opposite directions when Thomas turned left and struck Kelly. Both Kelly and a witness told police that Thomas had failed to yield to oncoming traffic, but Thomas claimed that he was not at fault. Kelly was taken to a hospital by ambulance and treated for a fractured femur. The cost of his medical care totaled $26,803.17. Thomas was insured by State Farm and his policy had a $25,000 limit.

Approximately six weeks after the accident, Kelly's attorney mailed a letter to State Farm regarding Kelly's injury. The letter included copies of Kelly's medical records and stated:

> I will recommend release of State Farm Insurance Company and your insured, Henry Thomas, for payment of your policy limits. Please give me a call in the next ten (10) days to discuss this matter.

Although the insurer did not respond to the letter within the 10 day period, Kelly's attorney spoke with the insurer's representatives twice. Both communications took place after the expiration of the 10 day period. The first conversation occurred approximately three months after the accident and the second took place approximately two weeks later. During the second conversation, a State Farm representative offered to settle the case for the policy limit and sent Kelly's attorney a letter memorializing the offer. The attorney rejected the offer and filed suit against Thomas.

The suit proceeded to trial. Thomas was found liable and a judgment was entered against him for $176,464.07. State Farm paid Kelly the policy limit of $25,000. Thomas then assigned his right to pursue a bad faith action against the insurer to Kelly in exchange for Kelly's promise not to enforce the judgment against Thomas's personal assets. Kelly filed suit in state court against State Farm alleging bad faith. The insurer argued that it could not be held liable for bad faith because it had never been presented with a firm settlement offer.

QUESTION: Can an insurer be found liable for bad faith failure to settle if the insurer never received a firm settlement offer?

ANSWER: The case made its way to the Louisiana Supreme Court. In *Kelly v. State Farm Fire & Casualty Company*, 169 So3d 328 (La. 2015), the court held that under Louisiana law an insurer can be liable for bad faith even in the absence of a firm settlement offer.

Louisiana's Unfair Claims Settlement Practices Act does not give a third party claimant the right to sue an insurer for breach of its duty of good faith and fair dealing. In this case, however, Kelly was not advancing his own claims, but Thomas's claims assigned to him, so Kelly was not barred by the statute.

The court cited Louisiana Revised Statute § 22:1973. The relevant section provides:

> A. An insurer ... owes to his insured a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.

The court focused on the "affirmative duty" language in the statute. The court noted that the phrase "affirmative duty" in the Louisiana Insurance Code is interpreted to mean "taking positive action(s) to comply with a legal standard." The statute lists two affirmative acts required on the part of an insurer to comply with the statute: first, to adjust claims fairly and promptly and; second, to make a reasonable effort to settle claims with the insured, the claimant, or both.

The insurer argued that the affirmative duty to settle is breached only when an insurer unreasonably refuses a firm settlement offer. Since Kelley's attorney merely said he would recommend a settlement, State Farm never unreasonably refused a firm offer to settle. The insurer also argued that in the absence of a bright line rule that requires a firm settlement offer, insurers would be faced with uncertainty about how they could satisfy their duty to reasonably settle claims. The court said that the relevant issue is not whether such a bright line rule is prudent, but instead, whether the statute includes such a requirement.

Again, the court focused on the language of the statute and sought to determine "whether an insurer's affirmative duty to make a reasonable effort to settle claims is triggered only by receipt of a firm settlement offer." In concluding that an insurer's reasonable effort to settle claims did not depend on receipt of a firm settlement offer, the court said:

> The clearest indicator is that a firm settlement offer is not listed anywhere in the statute. To impose the requirement of a firm settlement offer would essentially amount to adding words not included in the statute. As we understand State Farm's brief, not only would we have to essentially add wording requiring a "firm or actual offer to settle," but State Farm would have us further qualify that an offer must be "within the available policy limits." The wording proposed by State Farm amounts not to statutory interpretation, but to a wholesale rewriting of La. R.S. 22:1973(A). Such rewriting is not, however, the role of this or other Louisiana courts.

The court also said it would be impractical to determine that an insurer's obligation to act in good faith is only triggered by receipt of a firm settlement offer because neither an insured nor an insurer has any control over whether such an offer is made. Instead, the court said, an insurer's obligation to act in good faith is triggered by "knowledge of the particular situation." This means an insurer has an affirmative duty to investigate the claim and to act reasonably in light of that information. When an insurer has information that indicates a judgment in excess of policy limits is likely, to discharge its duty to act in good faith the insurer should consider initiating settlement discussions with the third-party claimant.

While the court rejected a firm settlement offer as a prerequisite to an insurer's liability for bad faith failure to settle, it did mention that such an offer would still be relevant on the issue of bad faith. The court said: "Such an offer would unmistakably put the insurer on notice the matter can be resolved and, if the offer were within the policy limits, shield the insured from an excess judgment." In Louisiana, therefore, a firm settlement offer is an important factor to consider, just not the only factor to consider. The court explained the utility of a case-by-case evaluation:

> The determination of good or bad faith in an insurer's deciding to proceed to trial involves the weighing of such factors, among others, as the probability of the insured's liability, the extent of the damages incurred by the claimant, the amount of the policy limits, the adequacy of the insurer's investigation, and the openness of communications between the insurer and the insured.

Finally, the court observed that the law of bad faith should be cautiously applied and suggested that its decision should not be considered a license to engage in gamesmanship to set up an insurer for an excess liability judgment. Ultimately, the question of insurer liability is determined by the reasonableness of an insurer's conduct at the time it decided to proceed to trial. An insurer does not act in bad faith by refusing to negotiate a settlement based on a reasonable belief that its insured was not liable for the accident and resulting damages.

Although the court did not decide the case on the merits, it did conclude that an insurer can be found liable for a bad faith failure to settle under the Louisiana statute even though the insurer never received a firm settlement offer.

While this case involved an insurer's bad faith liability under the specific language of the Louisiana statute, other states have reached the same conclusion based on their own statutes and case law. The following states are among those where a settlement demand is not required for a finding of an insurer's bad faith failure to settle.

Florida	*Powell v. Prudential Property & Casualty*, 584 So2d 12 (Fla. App. 1991) "Bad faith may be inferred from a delay in settlement negotiations which is willful and without reasonable cause. Where liability is clear, and injuries so serious that a judgment in excess of the policy limits is likely, an insurer has an affirmative duty to initiate settlement negotiations."
New Jersey	*Rova Farms Resort v. Investors Ins. Co.*, 323 A2d 495 (N.J. 1974) "An insurer, having contractually restricted the independent negotiating power of its insured, has a positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage."
New Mexico	*City of Hobbs v. Hartford Fire Ins. Co.*, 162 F3d 576 (10th Cir. 1998) "Good faith in New Mexico imposes upon the insurer the duty to settle wherever practicable. We believe New Mexico would not limit this duty to cases only where the claimant made a firm offer."
Oregon	*Eastham v. Oregon Auto Ins. Co.*, 540 P2d 364 (Or. 1975) "We recognize that an insurer may be found to have acted in bad faith in failing to make or in unduly delaying an offer or counteroffer to settle."
Tennessee	*State Auto Ins. Co. v. Rowland*, 427 SW2d 30 (Tenn. 1968) "To hold as a matter of law that an insurance company cannot be guilty of bad faith unless it has received an offer of settlement within the policy limits could most certainly lead to inequitable results."
Wisconsin	*Alt v. American Family Mut. Ins. Co.*, 237 NW2d 706 (Wis. 1976) The Supreme Court of Wisconsin adopted the reasoning of the New Jersey Supreme Court in *Rova Farms* that the insurer "has a positive fiduciary duty to take the initiative, and attempt to negotiate a settlement within the policy coverage."