

The Tried, the True,
and the New

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Counsel defending against actions for bad-faith failure to settle have many arrows in their quiver, both substantively and procedurally.

Defenses to Claims of Bad-Faith Failure to Settle

As Chuck Norris so aptly stated, “the best defense is not to offend.” Applying this adage, insurance companies take seriously their obligation to defend their insureds under liability policies. The decision of whether to settle and

foreclose an insured’s exposure, or refuse to settle, leaving the insured potentially exposed to damages in excess of the policy limits, carries significant ramifications. Because an insurer must not put its own interests ahead of those of its insured, the decision to try a case when it could be settled must be based on adequate investigation of the facts, careful evaluation of liability and damages, assessment of the anticipated verdict range, and the strengths and weaknesses of all evidence to be presented. Still, even the most careful and diligent carrier often finds itself being set up to “offend” by claimant’s counsel and even by its own insured. Insurers can and should take proactive steps to navigate through potential bad-faith setups during the claims process. But when best practices are not enough to prevent an excess judgment and the subsequent suit for bad-faith failure to set-

tle, what tools are available to an insurer to defend against such claims? This article explores substantive and procedural defenses to actions alleging bad-faith failure to settle; some are tried and true, and some are new.

Tried, True, and New Substantive Defenses

In an action alleging bad-faith failure to settle, depending on the circumstances, an insurer will have options to consider to defend against the claim, including lack of coverage, advice of counsel, conformity to industry standards, no valid settlement demand, and the insured’s breach of contract. An insurer may also argue that the insured settled without the insurer’s consent, the claimant “set up” the insurer, or the insured comparatively acted in bad faith, which would preclude the insurer’s conduct.



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Lack of Coverage

The lack of coverage, or lack of duty to defend, is perhaps the most basic defense to claims of bad-faith failure to settle. See *Wehrenberg v. Metro. Prop. & Cas. Ins. Co.*, No. 17-1327, 2017 WL 5479474, at *3 (3d Cir. Nov. 15, 2017) (“Generally, there can be no bad faith claim for denial of coverage if the insurer was correct as a matter of law in denying coverage.”); *Travelers Cas. & Sur. Co. v. Stewart*, 663 Fed. Appx. 784, 788 (11th Cir. 2016) (“In the absence of any duty to provide coverage there is no bad faith, so we must affirm the district court’s dismissal for failure to state a claim.”). Thus, a careful, complete review of the insurance policy at issue is critical since in many jurisdictions, without coverage, there cannot be “bad-faith” on part of an insurer.

Advice of Counsel

The advice of counsel defense, whereby an insurer relies on its having followed the advice of counsel to protect itself from allegations of bad faith, is a double-edged sword because in choosing to assert the defense, the carrier effectively puts the attorney–client privilege “at issue.” See, e.g., *In re Fresh & Process Potatoes Litigation*, No. 4:10-md-02186-BLW-CWD, 2014 WL 2435581, at *5 (D. Idaho May 30, 2014). Therefore, in considering whether to assert the defense, counsel should meticulously evaluate whether an insurer acted in good faith, whether the insurer was provided good advice from its lawyer, whether that lawyer had the necessary facts to render the advice, whether the insurer actually heeded the advice, and whether all documents and communications support the defense. Obviously, the carrier must be willing to waive the attorney–client privilege pertaining to all communications with coverage counsel and should expect that coverage counsel will be deposed.

If these elements are met, advice of counsel can be an effective defense to a bad-faith failure to settle action. See *Kalberer v. Am. Fam. Mut. Ins. Co.*, 692 Fed. Appx. 488, 489 (9th Cir. 2017) (affirming summary judgment in favor of insurer because, among other reasons, “[t]he evidence demonstrate[d] that American Family, through the advice of counsel and retained medical experts, had reason to believe that proceeding to trial could have resulted in a

more favorable outcome than settling the case”); see also *Andrews v. Ridco, Inc.*, 863 N.W. 2d 540, 547 (S.D. 2015) (recognizing advice of counsel as a well-established affirmative defense to bad-faith failure to settle claims); *Davis v. Cotton States Mut. Ins. Co.*, 604 So. 2d 354, 359–60 (Ala. 1992) (“The record reflects an attempt by Cotton States and Shield to legitimately determine, in good faith, whether the kind of vehicle at issue was covered by the uninsured motorist provisions of the policies. That effort included employment of legal counsel to determine the extent of coverage and it indicates reliance on the lawyer’s advice. Under these facts, Cotton States and Shield have demonstrated an arguable reason for denying uninsured motorist benefits to Davis.”).

Counsel should be aware, however, that while some courts have allowed the advice of counsel defense in bad-faith failure to settle actions, other courts are not persuaded. *State Farm Fire & Cas. Co. v. de la Maza*, 328 So. 2d 547, 548 (3rd D. Fla. 1976) (holding the advice of counsel defense inapplicable where counsel failed to revise his legal opinion on the duty client owed to the plaintiff according to new, recently published law). Moreover, in courts where the advice of counsel defense is permitted, it may not serve as a complete defense but only as a factor in determining whether the insurer breached its duty to the insured. See *Thomas v. Safeway Ins. Co. of Ala., Inc.*, 2017 WL 3326700, at *8 (S.D. Ala. Aug. 4, 2017); *Finger v. State Farm Fire and Cas. Ins. Co.*, No. 10-00192-KD-B, 2011 WL 2621020, at *4 (S.D. Ala. July 5, 2011); *Budde v. State Farm Mut. Auto. Ins. Co.*, No. 5:09-cv-00053, 2011 WL 1695838, at *4 (W.D. Ky. May 4, 2011). Finally, as with all arguments, if the defense has holes, it may be best not to assert it. See *Bamford, Inc. v. Regent Ins. Co.*, 822 F.3d 403, 412 (8th Cir. 2016) (“Here, the jury could have concluded that Regent—by relying on valuations received from mediators, counsel, and internal adjusters—reasonably embraced a low value for the Davises’ claims early in the case, but ultimately acted in bad faith in failing to reassess the value of the claims in light of case developments and advice from its own players that the low value was inaccurate.”). Given these potential risks, advice of counsel should not be the only defense relied

on, and in some instances, it should not be asserted at all.

Conformity to Industry Standards

Counsel may assert that an insurer conformed to industry standards, and therefore, the insurer did not act in bad faith. The reasonableness of an insurer’s actions typically are examined objectively and

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in accordance with standards generally followed in the insurance industry. Such standards are usually established through expert testimony. The conformity to industry standards defense should certainly be considered along with other bad-faith failure to settle defenses. The Eleventh Circuit recently considered an insurer’s conformance to industry standards and held that its failure to include an insured’s statement about additional insurance in its insurance disclosure as required by Florida law was nothing more than mere negligence, and taken as a whole, the insurer’s efforts to settle the claim were diligent and reasonable. *Kwiatkowski v. Allstate Ins. Co.*, No. 17-11068, 2017 WL 5900553, at *2–3 (11th Cir. Nov. 30, 2017). Conformity to industry standards can be an effective defense if an insurer’s actions are justifiably reasonable in accordance with the objective standard.

Lack of Valid Settlement Demand

An action for bad-faith failure to settle likely will be unsuccessful absent a valid settlement demand from the tort plaintiff or policyholder because without such a demand, there is no duty to settle. To determine whether a demand is “valid,” counsel

must look to jurisdictional requirements. Whether a policy limits demand is required in a particular jurisdiction will affect this analysis. *See Kelly v. State Farm Fire & Cas. Co.*, 169 So. 3d 338, 341 (La. 2015) (“[A]n insurer can be found liable for a bad-faith failure-to-settle claim under [Louisiana statute], notwithstanding that the insurer never received a firm settlement offer.”).

An insured typically has a duty to cooperate with an insurer’s investigation and defense of a claim and must timely notify the insurer of pre-suit demands or lawsuits.

Some jurisdictions require a policyholder to prove that he made a sufficiently definite settlement demand within policy limits and that the demand would have been accepted. For example, in *Purscell v. TICO Ins. Co.*, 959 F. Supp. 2d 1195, 1203 (W.D. Mo. 2013), TICO’s insured brought a bad-faith failure to settle action, alleging that TICO should have exhausted his insurance policy in settlement with the parties suing him, rather than continuing to investigate the parties’ claims. The court held, “[a]bsent a definite demand from the [policyholder] plaintiff that he wanted Infinity to exhaust the proceeds of the insurance policy by settling with the [claimants,] even in light of the pending wrongful death claim, there was not a sufficiently definite demand,” and therefore, no bad-faith failure to settle by the insurer. *Purscell*, 959 F. Supp. 2d at 1203. The court specifically held that it was “the lack of clear instructions” from the policyholder that prevented settlement with the parties suing the policyholder. *Id.*; see also *Am. Guar. & Liab. Ins. Co. v. United States Fidelity & Guar. Co.*, 668 F.3d 991, 1004 (8th Cir. 2012) (affirming summary judgment under Missouri law because the

insured’s bankruptcy trust never made a valid demand on the primary insurer to settle the underlying litigation within limits). The Eleventh Circuit recently held that a primary insurer’s alleged bad-faith failure to settle within policy limits was not actionable because there was no evidence that the excess insurer would have accepted the demand. *Westchester Fire Ins. Co. v. Mid-Continent Cas. Co.*, 569 Fed. Appx. 753, 756–57 (11th Cir. 2017).

Likewise, a demand made by one who has no authority to act on behalf of an injured party is a legal nullity, so it cannot serve as the basis for a bad-faith claim. *Fowler v. State Farm Mut. Ins. Co.*, No. 4:17-1081-RMG, 2017 WL 4737274, at *4-5 (D. S.C. Oct. 19, 2017) (insurer’s motion for judgment on the pleadings granted because a valid settlement demand was not made by someone with authority to act on behalf of an incompetent party), *appeal filed*. But see *Malcom v. Nat’l Am. Ins. Co.*, No. 15C8228, 2018 WL 888756, at *5–6 (N.D. Ill. Feb. 13, 2018) (holding in a bad-faith action after a failure to settle within policy limits that the insurer lacked standing to challenge the validity of the underlying plaintiffs’ settlement offer, based on their lawyer’s alleged lack of authority, because the insurer failed to provide support for the premise that the right to challenge the validity of a settlement offer is transferred to the offerree and evidence did not support the insurer’s argument that the plaintiffs’ counsel lacked authority). Thus, when evaluating the validity of a settlement demand, counsel should assess the competence of the opposing parties and the authority of those purporting to act on their behalf.

Insured’s Breach of Contract

In a traditional contract action, a plaintiff must prove that he performed all obligations required by the contract at issue. This defense translates into several categories in bad-faith failure to settle actions. A federal court in the Eastern District of California recently affirmed summary judgment in favor of a carrier on an insured’s breach of contract, bad-faith, and declaratory judgment counts because the insured misrepresented a material fact during his insurance claim, thus voiding coverage entirely. *Young v. Progressive Cas. Ins. Co.*, No. 1:16-CV-01198-DWM, 2017 WL

2462497, at *2–4 (E.D. Cal. June 6, 2017). *Young* exemplifies that an insured’s failure to comply with his insurance liability policy can constitute a breach of contract, thereby relieving the insurer of any duty to settle.

Moreover, an insured can breach his liability policy by failing to cooperate. An insured typically has a duty to cooperate with an insurer’s investigation and defense of a claim and must timely notify the insurer of pre-suit demands or lawsuits. The Eleventh Circuit affirmed summary judgment in favor of an insurer due to an insured’s failure to cooperate, holding that “[a]s a matter of law, the insured—at the time it settled the case in advance of trial—breached its duty to cooperate with its insurer in the investigation and defense of the underlying tort claim.” *Doe v. OneBeacon America Ins. Co.*, 639 Fed. Appx. 627, 628 (11th Cir. 2016) (per curiam). *OneBeacon* shows that an insured’s failure to cooperate can serve as a complete coverage defense. An insurer should meticulously document all communications with an insured, including the actions requested of the insured, the reasons why, and the consequences of the insured’s failure to cooperate. Developing this factual record will create a stronger defense under a failure to cooperate theory.

Insured’s Settlement Without Insurer’s Consent

Can an insurer be liable for bad-faith failure to settle if it did not consent to the underlying settlement? The insured’s settlement without consent typically would violate any “no action” clause in the liability policy, which functions to bar suits against the insurer until the liability of the insured is determined by a judgment; however, several jurisdictions hold that an insured can violate a “no action” clause and still maintain a bad-faith failure to settle claim. *See, e.g., Alexander Mfg., Inc. v. Ill. Union Ins. Co.*, 666 F. Supp. 2d 1185, 1201 (D. Or. 2009) (recognizing, under Oregon law, that an insured can violate a consent-to-settle provision if doing so does not prejudice the insurer and the insured acted reasonably, but holding that an issue of fact existed whether the settlement prejudiced the insurer); *Rupp v. Transcontinental Ins. Co.*, 627 F. Supp. 2d 1304, 1323 (D. Utah 2008) (precluding the insurers’ sum-

mary judgment for bad-faith failure to settle claim because fact issues existed pertaining to whether the insured's settlement agreement and stipulated judgment with the claimant were collusive or entered in bad faith when the insurers were unaware of final settlement agreement, but aware of settlement demands and evaluations, and rejected such demands, arguably breaching their fiduciary duties); *see also Twin City Fire Ins. Co., Inc. v. Ohio Cas. Ins. Co., Inc.*, 480 F.3d 1254, 1258 (11th Cir. 2007) (“[W]hen an insurer has a right to defend its insured, receives notice of settlement negotiations, and refuses to participate, the insurer waives the right to assert the no-action clause in a later suit to determine coverage.... The insurer ‘becomes bound to pay the amount of any settlement made in good faith,’ and for which coverage exists.” (citation omitted)).

However, other jurisdictions have reached contrary results. In *Piedmont Office Realty Trust, Inc. v. XL Specialty Ins. Co.*, the Georgia Supreme Court held an insured could not maintain an action for bad-faith refusal to settle without the insurer's consent to the settlement; thus, the court held the trial court did not err in dismissing the insured's complaint. 771 S.E. 2d 864, 867 (Ga. 2015); *see also Zurich Am. Ins. Co. v. Frankel Enterprises*, 509 F. Supp. 2d 1303, 1310 (S.D. Fla. 2007) (recognizing insurer cannot be bound by unauthorized settlement when it has not refused to defend). If the defense is applicable, an insured's failure to obtain the insurer's consent before settlement can bar a subsequent action for bad-faith failure to settle. In determining the applicability of the defense, courts consistently evaluate whether the insurer had a right and opportunity to defend, and if so, whether it refused to defend. However, apart from the right to defend, “there is no uniformity” among courts about whether an insured who breaches a no-action clause can still assert a bad-faith claim. *Piedmont*, 771 S.E. 2d at 867. Thus, practitioners must assess the law in their jurisdiction before evaluating the applicability of the lack of consent defense.

Bad-Faith “Setup”

A bad-faith “setup”—in which a claimant manufactures a bad-faith claim and

induces damages through a cat and mouse game with an insurer—is not a new phenomenon. Bad-faith setups most often occur in a third-party context in which the insurer is defending the insured, and the tort claimant attempts to manipulate the negotiation process so that the insurer will reject a policy limits demand. The claimant then gives the insured a covenant not to execute on the judgment, in exchange for an assignment of the insured's bad-faith claim. A setup can also occur in the first-party context: for instance, the insured will advise the insurer that any delay in responding will put the insured in serious financial difficulty, will prevent the insured from obtaining medical treatment, or will preclude repair to damaged property. In either scenario, first party or third party, a common tactic is to bombard the insurer with exaggerated demands with short time deadlines, unreasonable conditions, or allegations of exorbitant future medical costs or future surgeries.

Defending Against Time-Limited Demands

Time-limited demands have become part and parcel of a bad-faith setup, placing a carrier in an untenable position: either pay before liability can reasonably be determined, or risk losing the ability to settle, with all the consequences that entails. *See, e.g., Shannon v. N.Y. Cent. Mut. Ins. Co.*, 2013 WL 6119204, at *2 (M.D. Penn. Nov. 21, 2013). Such demands stem from the general principle that because the insurance policy gives the insurer the exclusive control over the decision to settle, it must make settlement decisions non-negligently, and in good faith. In some jurisdictions, failure to accept a time-limited demand may be considered by a court in evaluating alleged bad-faith failure to settle. For example, the Eleventh Circuit recently affirmed an award of over \$8 million in favor of a deceased motorist's estate, based on an insurer's failure to timely settle the estate's claims against the insured, who ran a red light, killing the decedent. *Camacho v. Nationwide Mutual Ins. Co.*, 692 Fed. Appx. 985, 985–86 (11th Cir. 2017). The estate made a \$100,000 policy limits demand, valid for 10 days, to settle the wrongful death and estate claims of the decedent's surviving family members, in exchange for a limited liability release that

would have protected the insured from personal liability except to the extent of other available insurance coverage. *Id.* The insurer responded to the demand after it expired, and while ultimately offering to settle for the policy limits, required a full general release, which the estate refused to accept. *Camacho v. Nationwide Mutual Ins. Co.*, 188 F. Supp. 3d 1331, 1340–41 (N.D.

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Ga. 2016). The estate then filed a wrongful death suit, in which a jury awarded \$5.83 million. In the ensuing bad-faith case, a jury found that the insurer “acted negligently or in bad faith in failing to settle.” *Id.* at 1336. Denying post-trial motions, the district court held that the carrier's failure to respond to the demand until after the deadline was not in line with industry custom and practice, and that by requiring a general release the insurer put its own interest ahead of the interest of its insured. *Id.* at 1340; *see also Moore v. GEICO Gen. Ins. Co.*, 633 Fed. Appx. 924, 929 (11th Cir. 2016) (reversing the trial court's order granting summary judgment for GEICO in a bad-faith failure to settle case following \$4 million excess verdict, despite evidence that the claimant's counsel had attempted to manufacture an artificial bad faith claim by conditioning the demand on receipt of affidavits from the insureds and a precisely worded release, and treat-

ing GEICO's transmittal of non-complying documents as a rejection of the policy limits settlement demand); *Century Sur. Co. v. Prince*, No. 2:16-CV-2465 JCM (PAL), 2018 WL 1524433, *9 (D. Nev. Mar. 28, 2018) (awarding more than \$63,000 in attorney's fees to counsel who represented a bicyclist injured in a motor vehicle accident in a bad-faith setup case).

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These cases hold important lessons for insurers. First, in states where time-limited demands are recognized, insurers ignore or slowly respond to such demands at their own peril, particularly in cases of clear liability and special damages exceeding policy limits. Because such demands are often used to cause an insurer to "offend," it should respond within the proscribed time period. Second, an insurer's insistence on a general release in the face of a time-limited demand when the plaintiff would accept a limited liability release may constitute bad faith, if a limited liability release would be sufficient to protect the insured from the possible exposure of an excess verdict. Third, while the conduct of a claimant and his counsel is likely relevant to an insurer's defense of bad-faith setup and should be raised as a defense, courts tend to focus on the insurer's conduct to determine if it fulfilled its obligations to the insured, rather than on the claimant's conduct in "setting up" the insurer.

Defending Against Consent or Rollover Judgments

When an insured and a tort plaintiff enter a consent or rollover judgment with a covenant not to execute against the insured's assets after a denial of a policy limits demand, various defenses are available to the insurer, depending on the jurisdiction. For example, some courts hold that consent judgments are not enforceable because the insured is not legally obligated to pay, and therefore, the insured has not sustained a loss under the policy. See *U.S. Bank v. Fed. Ins. Co.*, 664 F.3d 693, 696-99 (8th Cir. 2011). Others, however, hold that the insured remains legally obligated to pay because the covenant not to execute is merely an agreement not to collect, rather than a release of liability. See *Red Giant Oil Co. v. Lawlor*, 528 N.W. 2d 524, 532-33 (Iowa 2011). Likewise, courts are split on whether a consent or rollover judgment constitutes a breach of the insured's duty to cooperate. See *Warren v. Am. Nat'l Fire Ins. Co.*, 826 S.W. 2d 185, 188-89 (Tex. Ct. App. 1992) (holding a breach of the duty to cooperate occurred); *Besel v. Viking Ins. Co.*, 49 P.3d 887, 892 (Wash. 2002) (holding no breach of the duty to cooperate occurred). While most courts recognize the possibility for fraud and collusion inherent in consent judgments with covenants not to sue, there is little protection for insurers when the consent judgment is merely unreasonable. See *Tidyman's Mgmt. Servs., Inc. v. Nat'l Union Fire Ins. Co.*, 378 P.3d 1182, 1184-88 (Mont. 2016) (holding the insurer bore the burden of proving the unreasonableness of a stipulated judgment and a trial court should objectively consider the merits of the underlying case and the value to the insured to confess judgment in exchange for a covenant not to execute); *Miller v. Kenny*, 325 P.3d 278, 287-94 (Wash. Ct. App. 2014) (upholding stipulated judgment of \$21 million). Nonetheless, an insurer defending against an unreasonable consent judgment should assert unreasonableness as a defense and conduct discovery on reasonableness, if allowed. *Carpenter v. Lovell's Lounge and Grill*, 59 N.E.3d 330, 342 (Ind. Ct. App. 2016) (affirming the trial court's finding that a consent judgment was procured by bad faith or collusion and therefore was patently unreasonable).

Defending Against the "Setup"

As attempted setups become more prevalent, some courts have become more attuned to the claimants' game, giving insurers an opportunity to defend, based on the egregious nature of the claimant's conduct. See, e.g., *Wade v. Emcasco Ins. Co.*, 483 F.3d 657 (10th Cir. 2007). Additionally, in reaction to abusive setup practices and the failure of many courts to curb these abuses, some state legislatures are enacting statutes to protect insurers. See, e.g., Mo. Rev. Stat. §537.058 (2017) (requiring demands to remain open for a minimum of 90 days, be accompanied by medical releases and unconditional liability releases for the tortfeasor, and identify all parties being released); Ga. Code Ann. §9-11-67.1 (2013) (providing that demands arising from motor vehicle accidents on or after July 1, 2013, must remain open for minimum of thirty days).

Despite the widespread use of setup tactics, several jurisdictions do not recognize bad-faith set up as a defense. See *Hartford Roman Catholic Diocesan, Corp. v. Interstate Fire & Cas. Co.*, 199 F. Supp. 3d 559, 600 (D. Conn. 2016) ("[I]nsurer cannot 'lessen responsibility for its own tortious conduct' by putting forth affirmative defense of insured's bad faith." (citation omitted)), *appeal filed*; *State Auto P&C Co. v. Griffin*, No. 4:11-CV-14 (CDL), 2012 WL 1940797, at *2 (M.D. Ga. May 29, 2012); *Miller v. Kenny*, 180 Wash. App. 772, 810 (Wash. Ct. App. 2014); *Kransco v. Am. Empire Surplus Lines Ins. Co.*, 2 P.3d 1, 4 (Cal. 2000). However, in those that do, it can be a powerful defense to egregious facts. For instance, courts have held that it was reasonable for an insurer not to settle a claim within an unreasonably short time-limited settlement period. *Striegel v. Am. Fam. Mut. Ins. Co.*, No. 2:13-cv-01338-GMN-VCF, 2015 WL 4113178, at *6 (D. Nev. July 7, 2015). *Striegel* noted counsel had "a *modus operandi* of using similar demand letters in multiple cases in this District, which impose an unreasonable time constraint of two weeks on their demands for payment to set-up a bad faith claim," and the court referred counsel to the state bar for disciplinary review. *Id.*; see also *Dietz & Watson, Inc. v. Liberty Mut. Ins. Co.*, No. 14-4082, 2015 WL 2069280, at *2-3 (E.D. Pa. May 5, 2015) (tacitly acknowledging

a bad-faith setup as the basis for an affirmative defense and allowing the insurer to conduct discovery on voluntary payment and the insured's bad faith).

Even in states that do not specifically recognize bad-faith setup as a defense, an insurer can raise several related defenses:

- (1) The claimant's unwillingness to settle, unreasonableness of the settlement demand, or lack of reasonable opportunity to settle. See *Lopez v. Allstate Fire & Cas. Ins. Co.*, No. 14-20654-Civ-COOKE/TORRES, 2015 WL 5320916, at *3 (S.D. Fla. Sep. 14, 2015) (recognizing defense of no reasonable opportunity to settle which is "to be decided based on all the circumstances"); *Hayas v. GEICO Gen. Ins. Co.*, No. 8:13-cv-1432-T-33AEP, 2014 WL 5590808, at *11-12 (M.D. Fla. Nov. 3, 2014) (holding the bad-faith setup defense was precluded due to the insurer's failure to plead it, but allowing evidence of policyholder's unwillingness to settle).
- (2) Avoidance: a setup resulted in a judgment that could have been avoided had the claimant and insured acted reasonably. See *Shannon*, 2013 WL 6119204, at *2 (recognizing the perils of set up as a claimant's litigation strategy, and denying the motion to strike the insurer's setup defense).
- (3) Motive and intent of claimants and their counsel in setting up the insurer: some courts hold such is relevant and admissible. See, e.g., *Wade v. Emcasco Ins. Co.*, 483 F.3d at 673-74; *Barry v. GEICO Gen. Ins. Co.*, 938 So. 2d 613, 618 (Fla. Dist. Ct. App. 2006). But see *Moore v. GEICO Gen. Ins. Co.*, 633 Fed. Appx. at 931 (holding the district court improperly focused its analysis on the conduct of claimant's counsel, when it should have focused on the conduct of the insurer in fulfilling its obligations to its insured); *Nelson v. Progressive Northwestern Ins. Co.*, No. 15-7454-JWL, 2016 WL 880506, at *7 (D. Kan. Mar. 7, 2016) (denying summary judgment for insurer even absent a pre-suit limits demand and noting the inquiry hinges on whether the facts raise suspicion of a "cat and mouse" game between the claimants and insurer).

Counsel representing insurers in bad-faith failure to settle cases should be mind-

ful of the widely varying state statutory and common law, as well as current trends related to time-limited demands and consent or rollover judgments.

Insured's Comparative Bad Faith

Comparative bad faith is a defense based on an insured's own bad faith. This defense forces an insured to face consequences for deceptive behavior and was first recognized, though later eliminated, in California. See *Ca. Cas. Gen. Ins. Co. v. Superior Court*, 173 Cal. App. 3d 274 (Cal. Ct. App. 1985); *Kransco v. Am. Empire Surplus Lines Ins. Co.*, 2 P.3d 1 (Cal. 2000). To date, the majority of jurisdictions follow California's lead, refusing to embrace comparative bad faith as a defense to bad-faith failure to settle. Several jurisdictions have conclusively rejected comparative bad faith. See, e.g., *QuikTrip Corp. v. ACE Prop. & Cas. Ins. Co.*, No. 16-CV-508-GKF-FHM, 2017 WL 5071316, at *3 (N.D. Okla. Oct. 6, 2017); *McPartland v. Gov. Employees Ins. Co.*, No.: 6:09-cv-00268-Orl-35GJK, 2010 WL 11507564, at * 8 (M.D. Fla. May 19, 2010); *In re: Tutu Water Wells Contamination Litigation*, 78 F. Supp. 2d 436, 454-55 (D.V.I. 1999); *Wailua Assoc. v. Aetna Cas. and Sur. Co.*, 183 F.R.D. 550, 560 (D. Hawaii 1998); *Nationwide Prop. & Cas. Ins. Co. v. King*, 568 So. 2d 990, 990 (Fla. Dist. Ct. App. 1990) (per curiam); *Stumpf v. Continental Cas. Co.*, 794 P.2d 1228, 1233 (Or. Ct. App. 1990); *Stephens v. Safeco Ins. Co. of America*, 852 P.2d 565, 568-69 (Mont. 1993); *First Bank of Turley v. Fidelity and Deposit Ins. Co. of Md.*, 928 P.2d 298, 308 (Okla. 1996).

However, at least two courts have recognized a defense in which the insured and claimant engaged in collusion, made a voluntary payment without the carrier's consent, and sent a time-limited demand, which closed before important information was provided. See *Dietz & Watson, Inc. v. Liberty Mut. Ins. Co.*, No. 14-4082, 2015 WL 2069280 (E.D. Pa. May 5, 2015) (recognizing that if proved, the policyholder's bad faith would be a valid affirmative defense); *Shannon v. New York Mut. Ins. Co.*, No. 3:13-CV-1432, 2013 WL 6119204 (M.D. Pa. Nov. 21, 2013) (refusing to strike bad-faith setup as an affirmative defense). Counsel should develop evidence of particularly egregious conduct by the insured

and claimant, and when it is warranted, assert comparative bad faith unless it is prohibited by law.

Insured's Failure to Mitigate

The principle that a plaintiff has a duty to take reasonable efforts to mitigate his damages is deeply rooted in contract law. Notwithstanding the principle's "deep

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roots," few decisions specifically address an insured's duty to mitigate as a defense to bad-faith failure to settle actions. See James M. Fischer, *Does an Insured Have a Duty to Mitigate Damages When an Insurer Breaches?*, 20.1 Conn. Ins. Law Journal 90 (2014). In a sense, while the duty is not an assessment of fault, mitigation mirrors several liability doctrines, such as contributory negligence and comparative fault. Due to the uncertainty surrounding this defense, counsel should evaluate whether to assert it, but its benefit may be to reduce damages, rather than to avoid a failure to settle claim altogether.

Tried, True, and New Procedural Defenses

As with any other lawsuit, counsel's first line of business in defending against a bad-faith failure to settle action is to evaluate the complaint fully and determine the best way to respond procedurally. Based on the complaint's allegations, or the lack of them, the most appropriate response

may be a motion to dismiss. In *Cushman & Wakefield, Inc. v. Ill. Nat'l Ins. Co.*, the court found that an insured's claim against an excess insurer for breach of contract was not viable because the insured did not plead the breach of a specific policy provision. *Cushman & Wakefield, Inc. v. Ill. Nat'l Ins. Co.*, No. 14 C 8725, 2015 WL 2259647, at *8 (N.D. Ill. May 11, 2015). Following

While any statute of limitations defense must comply with the particular jurisdiction's complexities, it can be a viable defense to an action for bad-faith failure to settle.

Illinois law, the court also dismissed the insured's bad-faith claim because the insured failed to allege a breach of particular contractual obligation or any failure to negotiate a settlement in good faith. *Id.* at *6–9; see also *Larson v. One Beacon Ins. Co.*, No. 12–cv–03150–MSK–KLM, 2013 WL 5366401, at *15 (D. Colo. Sept. 25, 2013) (granting summary judgment in part because the insured failed to identify a specific contractual provision One Beacon allegedly breached). Numerous procedural defenses and strategies find application in actions alleging failure to settle.

Statute of Limitations

The existence of a statute of limitations defense in a bad-faith failure to settle action primarily depends on whether a particular jurisdiction deems the action to be one settled in tort or in contract. Once this issue is addressed, counsel must determine if the action was filed timely, and if appropriate, counsel should assert a statute of limitations defense in the first responsive pleading. See *Moye v. Avis Budget Group*, No. TDC–14–2714, 2015 WL 410515, at *4 (D. Maryland Jan. 27, 2015) (dismissing, based on the statute of limitations, “with

prejudice any tort claim against Avis alleging a bad faith failure to settle.”); *Lima Delta Co. v. Global Aerospace, Inc.*, No. 16C–11–241WCC CCLD, 2017 WL 4461423, at *7 (Superior Ct. of Del. Oct. 5, 2017) (granting insurer's motion to dismiss insured's complaint for various claims, including bad-faith breach of contract, because the three year statute of limitations had expired). But see *MI Windows & Doors v. Liberty Mut. Fire Ins. Co.*, 123 F. Supp. 3d 1332, 1335–36 (M.D. Fla. 2015) (holding insured's claim for bad-faith failure to settle was timely). While any statute of limitations defense must comply with the particular jurisdiction's complexities, it can be a viable defense to an action for bad-faith failure to settle.

Preemption, Collateral Estoppel, and Res Judicata

Furthermore, counsel should always consider whether preemption, collateral estoppel, or res judicata are viable defenses. See, e.g., *Highfill v. USAA Cas. Ins. Co.*, No. 3:11cv574/MCR/EMT, 2012 WL 13024795, at *5 (N.D. Fla. July 31, 2012) (applying collateral estoppel in a claim for bad-faith failure to pay underinsured motorist benefits). Cf. *Fowler v. State Farm Mut. Ins. Co.*, No. 4:17-1081-RMG, 2017 WL 4737274, at *4 (D. S.C. Oct. 19, 2017) (holding res judicata did not bar a second claim because a new theory of liability was presented), *appeal filed*. Issues relevant to the duty to settle, such as when a claimant knew the extent of his injuries, whether the claimant was contributorily negligent, or whether the claimant was competent to sue in the first place, may have been firmly established in the underlying case, making them subject to these defenses.

Removal and Fraudulent Joinder

Just as defense counsel would prefer to litigate a bad-faith failure to settle action in federal court on most occasions because of a more controlled discovery process and an often more sophisticated judiciary and jury, plaintiffs typically prefer state court. A plaintiff may name an in-state defendant against whom he has no possibility of stating a valid claim—frequently an individual insurance adjuster—simply to keep the action in state court. In such instances, a defendant should assert fraudulent joinder as grounds for removal and move to

dismiss the claims against the in-state defendant. However, the success of this strategy varies across states. For instance, some courts hold that a plaintiff cannot state a claim for relief against an insurance adjuster for bad faith, usually based on the rationale that the adjuster is not a party to the insurance contract, or based on the principle that a corporation cannot conspire with its agent. See *Good Shepherd Assisted Living Corp. v. Great Am. Ins. Co. of N.Y.*, No. 4:14–CV–3241, 2015 WL 2449161, at *5 (D. Neb. May 21, 2015); *Madison v. Nationwide Mut. Ins. Co.*, No. 1:11–CV–157–R, 2012 WL 692598, at *2–3 (W.D. Ky. Mar. 2, 2012); *Grubbs v. Westfield Ins. Co.*, 430 F. Supp. 2d 563, 567–68 (N.D. W.Va. 2006); *Tipton v. Nationwide Mut. Fire Ins. Co.*, 381 F. Supp. 2d 567, 570–72 (S.D. Miss. 2003). However, a growing minority of courts hold that fraudulent joinder of an in-house adjuster is not an effective procedural defense and does not support removal. See *Aung v. Geico*, No. 9:17-cv-856-PMD, 2017 WL 2416475, at *2 (D. S.C. June 5, 2017) (rejecting UIM insurer's assertion of fraudulent joinder of an employee claims adjuster in bad-faith failure to settle action, noting no South Carolina exception exists for in-house adjusters to the general rule that employees may be personally liable for torts committed in the scope of their employment); *IDS Prop. Cas. Ins. Co. v. Gambrell*, 913 F. Supp. 2d 748, 754 (D. Ariz. 2012) (holding the joinder of an adjuster was not fraudulent); *Wiseman v. Universal Underwriters Ins. Co.*, 412 F. Supp. 2d 801, 806 (S.D. Ohio 2005) (holding a reasonable basis could exist under Ohio law for imposing personal liability for bad faith on an adjuster).

Several courts have examined fraudulent joinder in situations other than those involving an employee adjuster. See *Noyes v. Universal Underwriters Ins. Co.*, 3 F. Supp. 3d 1356, 1362 (M.D. Fla. 2014) (holding the attorney who handled the underlying tort case was fraudulently joined to defeat diversity jurisdiction); *Clemmons v. Twin City Fire Ins. Co.*, 7:13–CV–01341–LSC, 2013 WL 12156033, at *5 (N.D. Ala. Dec. 3, 2013) (denying motion to remand based on fraudulent joinder of outside adjuster). While most of these cases are in the first-party context, some third-party cases do address this issue. See *Leonhardt v.*

Geico Cas. Co., No. 8:11-cv-1988-T-23TBM, 2011 WL 5359840, at *1–3 (M.D. Fla. Oct. 28, 2011).

A timely filed removal in bad-faith failure to settle action involving a diverse policyholder and insurer is typically permitted among the courts. See, e.g., *Fla. Health Scis. Ctr., Inc. v. Gov't Empls. Ins. Co.*, No. 8:17-cv-339-T-36AAS, 2017 WL 3720880, at *8–10 (M.D. Fla. Aug. 7, 2017); *Mansaray v. Mut. Ben. Ins. Co.*, No. PX 17-0098, 2017 WL 2778824, at *6–7 (D. Md. June 26, 2017); *Smith v. Farmers Ins. Co. of Az.*, No. 14-CV-1073 MCA/WPL, 2015 WL 13260403, at *3 (D. N.M. Dec. 17, 2015). However, counsel must be mindful to follow all necessary removal procedures strictly when seeking removal. See *Goree v. PV Holding Corp.*, No. 4:15-CV-202 (CEJ), 2015 WL 2238960, at *4 (E.D. Mo. May 12, 2015) (granting motion to remand because defendant failed to obtain a co-defendant's consent).

Bifurcation

While policyholders will resist, insurers may wish to pursue bifurcation of bad-faith failure to settle claims from coverage or contractual claims. Arguably bifurcation affords discovery protections, avoids juror confusion, promotes judicial economy, and may even increase settlement potential by determining threshold liability issues first, giving the parties a window through which to view the likely outcome of the bad-faith claims without incurring the expense and exposure attending to litigating those claims. However, the Eastern District of Pennsylvania recently rejected these arguments, denying an insurer's motion to bifurcate the plaintiff's contract claim from the statutory and common law bad-faith claims for purposes of discovery and trial, despite the fact that the plaintiff's bad-faith claims could fail if the insurer was successful in defending against plaintiff's breach of contract claim. The court held that the policyholder, rather than the insurer, would be prejudiced, and noted that in its view, bifurcation did not promote judicial economy. *Eizen Fineburg & McCarthy, P.C. v. Ironshore Specialty Ins. Co.*, 319 F.R.D. 209–214 (E.D. Pa. 2017).

Likewise, a federal court in the Southern District of Ohio denied a carrier's motion to bifurcate, holding that "it would be inconvenient and inefficient to bifurcate the trial

as the evidence presented [would] be relevant to all of Plaintiff's claims, including the bad faith claim." *Shah v. Metro. Life Ins. Co.*, No.: 2:16-cv-1124, 2017 WL 3288185, at *2 (S.D. Ohio Aug. 2, 2017); see also *Mulgrew v. Gov. Employees Ins. Co.*, No. 3:16-CV-02217, 2017 WL 4540612, at *3 (M.D. Pa. Oct. 11, 2017) (denying an insurer's motion to sever and stay a bad-faith claim); *Newhouse v. GEICO Cas. Co.*, No. 4:17-CV-00477, 2017 WL 4122405, at *5 (E.D. Pa. Sept. 18, 2017) (holding bifurcation was not warranted because "GEICO would have to provide information concerning how it values an insurance claim regardless of whether the bad faith claim was severed"); *Navigators Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, No. C12–13–MJP, 2013 WL 2155707, at *1 (W.D. Wash. May 16, 2013) (holding disposition of a coverage claim would not dispose of extra-contractual claims and denying the defendant's motion to bifurcate). But see *Shultzaberger v. State Farm Mut. Auto. Ins. Co.*, No. 2:17-cv-01028-KRS-CG, 2018 WL 456154, at *3 (D.N.M. Jan. 17, 2018) (granting motion to bifurcate, bifurcating the uninsured motorist (UIM) and bad-faith claims, and staying discovery except in the UIM claim); *Live Nation Worldwide, Inc. v. Secura Ins.*, No. 3:17-CV-216–CRS–CHL, 2018 WL 283265, at *4 (W.D. Ky. Jan. 3, 2018) (granting motion to bifurcate a bad-faith claim from other claims for discovery and trial purposes).

Policyholders opposing bifurcation will likely rely on the reasoning provided in *Eizen*. *Eizen*, 319 F.R.D. at 209. Therefore, when considering bifurcation for purposes of discovery, trial, or both, defense counsel must be aware of the arguments likely to come from the policyholder and supported by *Eizen*. Defense counsel seeking bifurcation should establish that the carrier will suffer prejudice if bifurcation is not allowed and that the claims require different proof and different elements so that efficiency dictates that they be tried separately.

Arbitration Provisions

Despite the strong policies in favor of arbitration and the procedural flexibility and resulting cost savings arbitration can provide, courts have become more critical of arbitration provisions. A California appellate court recently held that a state court had the discretion to deny a motion to compel arbi-

tration, despite an arbitration clause in the insurance agreement at issue, because the clause did not incorporate the application of the Federal Arbitration Act (FAA). According to the court, FAA provisions must be specified in a choice-of-law clause, and therefore, California procedural rules, not the FAA, applied. *Los Angeles Unified School Dist. v. Safety Nat'l Cas. Corp.*, 13 Cal. App.

While policyholders will resist, insurers may wish to pursue bifurcation of bad-faith failure to settle claims from coverage or contractual claims.

5th 471, 481–82 (Cal. Ct. App. 2017), petition for cert. filed; see also *Leonberger v. Mo. United School Ins. Council*, 501 S.W. 3d 1, 12–13 (Mo. Ct. App. 2016) (affirming denial of a motion to compel arbitration in bad-faith refusal to settle and bad-faith failure to defend litigation); *AG La Mesa v. Lexington Ins. Co.*, No. 10cv1873–IEG (BGS), 2011 WL 11504, at *5 (S.D. Cal. Jan. 3, 2011) (holding breach of contract claim against an insurer under an employment practices liability policy fell within the scope of the policy's arbitration clause, while the claim for breach of the covenant of good faith and fair dealing fell outside the scope of the clause). Before invoking an arbitration clause, therefore, counsel must thoroughly review the policy to identify any potential pitfalls that might prevent the matter from successfully being sent to arbitration.

Conclusion

Counsel defending against actions for bad-faith failure to settle have many arrows in their quiver, both substantively and procedurally. However, lawyers and the insurance companies they represent would be wise to take measures during the claims process to avoid missteps and stop potential bad-faith setups before they start. After all, the best defense is not to offend. 