Due unto Others
Applying the Golden Rule to the Problem of Insufficient Limits

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TIP
Time heals all wounds, but sometimes policy limits can’t satisfy all claimants. Protect your clients with a comprehensive plan.

Following a catastrophic accident, it is often apparent that the insured who caused the accident has insufficient liability insurance to satisfy all potential claims. The situations are varied: a single injured person with substantial medical liens; multiple claimants against a single insured; or multiple claimants against multiple insureds. This article explores three options for resolving multiple claims when there is insufficient coverage: global settlement negotiations, partial settlements, and interpleaders. No single option will work in all cases, but one or more of them will resolve most cases. In choosing the best option for a particular case, the insurer is well served by following the Golden Rule: It should manage the policy limits as if it were the insured. By observing this principle, the insurer best protects the insured and itself from excess exposure.

Courts generally recognize that an insurer owes a duty to its insured to properly manage the policy limits when there are multiple claims and insufficient coverage amounts. As one court explained, the duty to manage policy limits is part of the insurer’s duty to fairly consider settlement offers, giving equal consideration to the insured’s interest. How does an insurer satisfy this duty? In nearly every case, the first approach should be to aggressively pursue a global settlement on behalf of the insured, through mediation or informal negotiations. If these efforts fail, the insurer must consider other tools to resolve the claims. Two such options include filing a prompt interpleader action involving all claimants, and attempting to settle claims on a piecemeal basis.

Global Settlement Negotiations
Whenever possible, the insurer should pursue a global settlement of all claims against the insured, either through mediation or direct negotiations. Pursuit of a global settlement offers the following advantages over other alternatives:

- A global settlement provides maximum protection for the insured.
- Because negotiations are flexible, even an unsuccessful global mediation can set the stage for partial settlements or other solutions.
- A global settlement terminates the insurer’s obligation to pay for the insured’s defense. In contrast, an insurer that interpleads the limits into court may have an ongoing duty to defend.

The key to achieving a global settlement is early and thorough investigation of all potential claims. The insurer should swiftly confirm there is coverage for the claims. Once the settlement demands begin, it may be too late to conduct a thorough coverage investigation.

After determining the claims are covered, the insurer should promptly inform all potential claimants of the limited nature of available coverage. Many jurisdictions hold that when an insurer knows its policy limits are insufficient, it has a duty to proactively initiate settlement negotiations rather than wait to receive policy limits settlement demands. There is no advantage to waiting for demands; it can only create problems for the insurer. There also is no benefit to concealing the policy limits from the claimants.

An insurer should contact all potential claimants, regardless of whether they have asserted a claim or retained counsel. In a personal injury case, the insurer should immediately begin gathering medical records and medical liens information. The insurer should inquire about other potentially applicable insurance, including excess insurance, other parties’ liability insurance, and first-party coverages such as uninsured/underinsured motorist and medical payments coverage. In addition, the insurer should attempt to assess the insured’s financial condition because claimants may inquire about the insured’s ability to contribute toward a settlement.

By obtaining all available insurance information, the insurer can increase the potential for a global settlement. Some claimants may have additional sources of recovery. For example, passengers in the insured’s vehicle may have claims under medical payment coverage or underinsured motorist coverage that are not available to occupants of another vehicle. These additional resources may prove invaluable in pooling sufficient money to settle all claims.

Before the mediation, the insurer may conduct informal, direct negotiations with the claimants. However, a mediation involving all claimants is more likely to lead to a global settlement than informal, separate negotiations with each claimant. The insurer could offer to pay the mediator’s fee to encourage all parties to participate in a global mediation. Such a gesture may be particularly meaningful because the claimants will almost certainly be offered less than the full value of their claims. The insurer is paying the...
mediator’s fee, it may also benefit by selecting the mediator. This allows the insurer to choose a mediator it knows can handle the complexities of a global resolution.

Keeping the insured informed during all stages of the negotiations is crucial. The insurer should notify the insured of his or her right to obtain personal counsel and ask the insured to attend any mediation. The insurer must immediately inform the insured of any settlement demand made by the claimant or by another carrier and should explain the impact of the demand on other claims. Courts have held that the failure to notify the insured of a demand in excess of the policy limits may be evidence of bad faith.6

Keeping the insured informed of settlement negotiations is important for two reasons. First, the insured may opt to contribute toward an offer in excess of the policy limits to avoid personal exposure. This is particularly true for corporate defendants and individuals with substantial assets. Second, even if the insured does not have the desire or resources to contribute, he or she will be better able to provide input to the insurer on whether to agree to a partial settlement, if the need arises. A partial settlement with the insured’s stamp of approval is less likely to result in a later claim of bad faith. Conversely, if the insured is not kept apprised of the negotiations, he or she will be unable to provide meaningful input to the insurer.

Despite the insurer’s best efforts, there will be situations where a global resolution is not possible. The insurer’s next move may depend on why the global negotiations fail. For example, if one of the claimants attempts to “jump the line” by presenting a time-sensitive policy limits demand, the insurer may need to file an interpleader action before the demand expires. If, however, the mediation fails for other reasons, the insurer may be able to satisfy its duty to its insured by pursuing piecemeal settlements with the claimants.

Partial Settlement Agreements

In general, an insurer is free to enter into reasonable, good faith partial settlements when there are multiple claimants, even if such settlements deplete the available policy proceeds to pay for other claims.7 However, such a course of action may result in an inequitable distribution of the policy funds.8 For this reason, some courts reject a “first in time, first in right” approach to settlement.9

The biggest problem with partial settlements is that they leave the insured open to potential exposure, and the insurer open to claims of bad faith.10 A comparison of two cases illustrates this point.

In Texas Farmers Insurance Co. v. Soriano, the insured was involved in a head-on collision where two people were killed and three others were injured.11 The insured only had the minimum coverage: $10,000 per person and $20,000 per occurrence. The insurer offered the full policy limits to one claimant—a husband who was injured and whose wife was killed. The husband declined, wishing to investigate the insured’s assets. The insurer later settled the other wrongful death claim for $5,000. Afterward, the insurer offered the remaining $15,000 to the husband. The husband refused and demanded the initial $20,000 offer. The husband received a judgment against the insured for $172,000, and the insured assigned his rights against the insurer in return for a covenant not to execute. In the bad faith suit, the jury awarded $520,000 in compensatory damages and $5 million in exemplary damages. The Texas Supreme Court reversed this judgment, holding that as long as a settlement is reasonable, the fact that it reduces the available policy limits does not amount to bad faith:

To be sure, in settling the [smaller] claim, [the insurer] necessarily reduced the amount of insurance available to satisfy the [larger] claims, but [the insurer] also reduced [the insured’s] liability exposure. We conclude 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.12

Although the verdict was reversed in Texas Farmers, other courts have allowed the jury to decide whether an insurer was justified in entering a partial settlement. The Second Circuit Court of Appeals reached this result in Brown v. United States Fidelity & Guaranty Co.13 Brown involved an automobile accident where four people were seriously injured. The policy contained limits of $10,000 per person and $20,000 per occurrence. The insurer settled two of the four claims for $8,000 and $6,000, leaving only $6,000 for the last two claims. Due to various allegations by the claimants, the court held that the issue of bad faith should be decided by the jury. Importantly, there was no allegation that the two partial settlements were unreasonable when viewed independently. Thus, even reasonable partial settlements may leave room for a jury to find bad faith.

Other courts have also determined that whether a partial settlement was made in bad faith, such as in an attempt to avoid further defense obligations, is a question for the jury to decide.14 In addition, some special circumstances, like wrongful death statutes, may make piecemeal settlements particularly risky for an insurer.15 Because of such decisions, piecemeal settlements must be negotiated with care. This is where the insured’s input becomes critical. If an insured is advised of the risks and benefits of a piecemeal settlement, his or her approval or rejection of the settlement may insulate the insurer from any claim of bad faith management of the limits.

When a partial settlement is not achievable or advisable, the insurer should strongly consider the possibility of an interpleader action. This is particularly true when the insurer faces a time-sensitive policy limits demand from one of the claimants.

Interpleader Actions

Interpleader actions have become an increasingly effective way for insurers to address the needs of multiple claimants when those claims will likely exceed policy limits. In 1967, the U.S. Supreme Court held in State Farm Fire & Casualty Co. v. Tashire that a change in the language of the federal interpleader statute authorized insurance companies to bring an interpleader action against
potential claimants without requiring that at least two claimants reduce their claims to actual judgments. This meant that insurance companies could use interpleader to avoid some pitfalls of determining which claims to pay first.

Federal interpleader has certain jurisdictional requirements. This is further complicated by the fact that the jurisdictional requirements are different depending on whether the insurer is relying on rule interpleader (Fed. R. Civ. P. 22) or the interpleader statute. Under Rule 22, complete diversity is required between the insurer and the defendants, and the amount in dispute must be at least $10,000. Under statutory interpleader, the insurer’s domicile is irrelevant, but there must be minimum diversity between at least two claimants (i.e., if any two claimants are from different states, that is sufficient), and the amount in controversy requirement is only $500. Because policy limits typically exceed $10,000, insurers can usually avail themselves of the federal courts unless the insurer and all of the claimants are from the same state.

Even in this situation, an insurer can typically file an interpleader action in state court. This is because many states allow interpleader either by statute, or by rule. In either system, the essence of an interpleader action is to allow a “stakeholder” (here, the insurer) to bring all the claimants to a particular fund (here, insurance proceeds) into court to assert their various claims, as long as those claims are mutually exclusive. The situation of limited policy limits and large claims for damages presents these circumstances. Once the interpleader action commences, the court may enjoin actions in other courts relating to the same fund. This power has limits, however. As the U.S. Supreme Court noted in Tashire, the court may not enjoin personal injury actions against the insured; it may only enjoin actions for the proceeds of the policy made against the insurer itself. Thus, when an interpleader action is initiated, the injured parties may still seek personal judgments against the insured, and the insurer is typically obligated to continue paying for the insured’s defense.

Under strict interpleader, the stakeholder was required to admit liability for the full amount and pay the amount into court before the proceeding could take place. Now, however, a “bill in the nature of interpleader” allows an insurer to protect itself against multiple claims while still claiming an interest in the property or fund. Thus, depending on the jurisdiction, an insurer may be able to file a bill in the nature of interpleader and still assert coverage defenses.

**When interpleader may not pay.** Once good faith global negotiations have failed due to one or more claimants demanding the full individual policy limits, a prompt interpleader action may preclude allegations of bad faith failure to settle. However, as courts and commentators have noted, interpleader is not always a viable option. This is illustrated in Kelly v. Farmers Insurance Exchange. In Kelly, the claimant offered to settle for policy limits, but the insurer was concerned about subrogation rights that might be asserted by the claimant’s uninsured motorist carrier. The insurer filed an interpleader, and the claimant was ultimately awarded the full policy limits because the court found that the uninsured motorist carrier had no valid claim to subrogation. In the meantime, however, the claimant had obtained a judgment against the insured. In a bad faith action, the court held that the insurer should have evaluated the two competing claims before filing an interpleader. If it had done so, it would have realized that there was no valid subrogation claim, and it could have settled the claim. Because of its failure to do so, the insurer was liable for the full judgment.

In addition to carefully investigating the validity of the competing claims, an insurer must also bear in mind the insured’s assets. Due to the holding in Tashire, an interpleader action cannot enjoin tort suits against the insured. In the case of an insolvent or “judgment proof” insurer, this may not pose a barrier to interpleader. As a practical matter, the claimants and their attorneys are not likely to expend time and resources to obtain a judgment they will never collect; they are more likely to grant a release for whatever amount the interpleader judge determines is equitable. However, if an insured has significant assets, claimants will likely seek a personal judgment despite the interpleader, and the insured is left largely unprotected. Again, it is best to work closely with the insured to determine the best strategy to minimize the insured’s exposure. This will often mean attempts to settle some claims with the insurance proceeds in order to reduce the overall value of the combined judgments.

An interpleader action may not protect an insurer from liability in excess of policy limits if the insurer has already settled with some claimants. In Waters Edge Living, LLC v. RSUI Indemnity Co., the Eleventh Circuit held that an insurer may still be bound to pay the full amount of a settlement agreement even though an interpleader court apportioned a smaller amount to the claimant. Also, negotiating a settlement agreement after an interpleader is filed may be inappropriate. In Preferred Risk Mutual Insurance Co. v. Greer, the U.S. District Court of South Carolina refused to allocate interpled funds to effectuate a separate settlement agreement reached between the insured and two of the claimants. In doing so, it noted that such allocation would defeat the purpose of an interpleader action, which was to help ensure an equitable allocation of insurance proceeds among all claimants. In light of the holding in Waters Edge, an insurer should therefore refrain from attempting separate settlement negotiations once an interpleader has been filed. If it does so, it may be held liable for the amount of the settlement above what is awarded by the interpleader court. Interpleader does not, however, preclude another attempt by the insurer at reaching a global settlement with all claimants.

**Defense cost during interpleader.** The insurer should also look to the policy language to determine whether it is required to continue to pay for a defense in the tort case(s) after it has interpled its entire policy limits. For example, when the duty to defend is separate from the duty to indemnify, the court may require the insurer to continue to fund the insured’s defense. Under a different type of policy, the Seventh Circuit has found that an insurer has no duty to defend once the policy limits have been interpled. In Abstract & Title Guaranty Co. v. Chicago Insurance Co., a professional liability policy set forth a $500,000 limit, both individual and aggregate. The policy provided that “claim expenses,” including the cost to defend, were included within those limits. The policy also provided that the insurer could withdraw from defense once the policy limits were exhausted. Over a hundred claims were filed against the insured, amounting to over $15 million. The court held that under those circumstances, the insurer had no duty to defend once the limits had been paid into the court. It noted that to hold otherwise would reduce the amount available to the other interpled claimants. It also noted that, as a party to the interpleader action, the insured could argue its case for...
reimbursement of defense costs out of the interpleaded funds.

Even under an automobile policy, some courts have found that there is no duty to defend after paying the policy limits into court, as long as the interpleader action is filed before the first lawsuit is filed. Thus, when determining whether it has a duty to defend after paying its policy limits into court, an insurer should consider (1) the policy language, (2) when the lawsuit was filed, and (3) binding precedent in the interpleader jurisdiction. Even then, an insurer may wish to consider filing a prompt motion for a declaration that it has no duty to defend before withdrawing from defense.

A Practical Approach
While each case is different, the following approach may be useful for an insurer facing multiple claims and insufficient policy limits.

1. Immediately identify and resolve all coverage issues.
2. Promptly and thoroughly investigate all potential claims. The investigation should include:
   • Identifying meritless claims;
   • Obtaining the claimants’ medical records;
   • Obtaining the claimants’ medical liens;
   • Obtaining other available insurance, including liability and first-party coverages; and
   • Assessing the insured’s financial condition.
3. Once it is determined that the limits are insufficient, the insurer should notify all claimants and insureds of this fact. The insurer should pursue a global settlement through mediation or direct negotiations. The insurer should strongly consider offering to pay the mediator’s fee to eliminate this cost as a barrier to settlement.
4. The insurer should keep the insured informed of the settlement negotiations. If a demand is made above the policy limits, the insured should be afforded the opportunity to contribute personally.
5. If global negotiations fail or are not feasible, the insurer has two choices. It can pursue piecemeal settlements, keeping the insured closely apprised and considering the insured’s input. Alternatively, the insurer may decide to file an interpleader action, rather than agree to any partial settlements. The interpleader action must be filed before any settlement offer expires.
6. Once the interpleader action is initiated, side discussions regarding partial settlements should cease. The full policy limits (or remaining policy limits) should be paid into the court at this time. The insurer should review its policy and do some preliminary research to determine if its obligation to defend ceases. If the answer is unclear (or even if it seems clear), the insurer should consider seeking declaratory relief from the court on this issue.

Conclusion
The situation of multiple claims with insufficient limits is one area where the interests of the insured and insurer are aligned. Both share the goal of obtaining the maximum protection for the insured. By applying the Golden Rule, and utilizing the tools discussed above, the insurer can go a long way to protecting both the insured and itself.

Notes
3. Id. at 284 (holding that insurer who interpleads funds must continue to provide a defense for the insured).
5. Voccio v. Reliance Ins. Cos., 703 F.2d 1 (1st Cir. 1983) (approving of insurer’s attempt to negotiate settlement directly with both claimants’ counsel).
7. Voccio, 703 F.2d 1 (holding that insurer did not act in bad faith when it offered to split the $25,000 policy limits evenly between two significant claims); 3-23 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 23.02 (2010) (citing cases).
9. See id. at 284.
10. See, e.g., Farinas v. Fla. Farm Bureau Gen. Ins. Co., 850 So. 2d 555, 561 (Fla. Dist. Ct. App. 2003) (noting that insurer may settle with less than all claimants, but whether its decision is reasonable or in bad faith is a fact question for the jury).
11. 881 S.W.2d 312 (Tex. 1994).
12. Id. at 315 (footnote omitted).
13. 314 F.2d 675 (2d Cir. 1963).
18. See, e.g., KAN. STAT. ANN. § 60-222.
20. Tittle v. Enron Corp., 463 F.3d 410, 425 n.11 (5th Cir. 2006).
21. Id.
23. 3-23 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION, supra note 7, § 23.02.
24. 239 Cal. Rptr. 259 (Ct. App. 1987).
25. 355 F. App’x 318 (11th Cir. 2009) (noting that jury could find that insurer assumed a “contractual obligation independent of the policy” by entering into a settlement with one claimant).
27. McReynolds, 235 P.3d at 284.
28. 489 F.3d 808 (7th Cir. 2007).