

## **DUTY TO SETTLE WHEN FACED WITH MULTIPLE CLAIMS AND LIMITED POLICY LIMITS**

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With the increasing number of bad faith claims being brought, the manner in which an insurer adjusts claims is highly scrutinized. This scrutiny is accentuated when an insurer is faced with the difficult task of adjusting more than one claim within a policy period, with each of these claims having a potential value exceeding the policy limit. Any insurer's effort to settle some, but not all of the claims within a policy period, will draw the attention of an insured and his/her counsel. This article will discuss methods by which an insurer can achieve the goal of resolving at least some of the claims while fulfilling its duty of good faith.

#### **A. GOOD FAITH DUTY**

Insurers are undoubtedly faced with conflicting choices when there are multiple claims within a policy period. Most States specifically require good faith and fair dealing in every contractual situation, which includes the duty to deal fairly in the handling and disposition of a claim. The insurer must accord the interest of its insured the same faithful consideration it gives its own interest. This balancing act does not mean that the insurer is bound to submerge its own interests and make the insured's interest paramount. Rather, this simply means that, when there

is little possibility of a verdict or settlement within policy limits, the decision to expose the insured to personal pecuniary loss must be based on a bona fide belief by the insurer, based on all the circumstances of the case, that it has a good possibility of winning the suit. This “good faith” requires that the chance of finding non liability against the insured be real and substantial and that the decision to litigate be made honestly. A decision not to settle must be thoroughly honest, intelligent and objective, as well as realistic when tested against the assumed expertise of the insurer.

This duty of good faith extends into the arena where an insurer is faced with multiple claims within a policy period which potentially exceed the value of the insurance policy proceeds. Most courts have held that the insurer is justified in exhausting the limits of its policy in settlement of some of the claims of multiple claimants to the exclusion of others, provided that the insurer in doing so exercises good faith. The courts look favorably upon these actions by insurers because it is good public policy to encourage settlement rather than litigation. For example, in *Richard v. Southern Farm Bureau Casualty Ins. Co.*, 254 La. 429, 223 So. 2d 858 (1969), the court upheld the insurer’s decision to settle with some of the claimants to the exclusion of others, even though the settlement exhausted its coverage, leaving the other claimants without recourse against the insurer. In *Bennett vs. Conrady*, 180 Kan. 485, 305 P.2d 823 (1957), the court approved the insurer’s actions where it settled with two of the five claimants, reducing its limits to the extent that the other three claimants could not be fully satisfied. Another court even sanctioned the actions of an insurer, which acting in good faith, settled a claim for one insured to the detriment of another insured. In *Anglo-American Ins. Co. v. Molin*, 670 a.2d 194 (Pa. Commw. Ct. 1995), the insurer issued a policy under which its insureds were covered by an aggregate limit of liability for any wrongful act committed by them. A

settlement offer was made on behalf of one defendant that would have exhausted the policy limits and left the remaining insured without insurance coverage for the claim. The court approved the insurer's actions, holding that because the settlement was reasonable, the insurer could exhaust the policy limits on behalf of one insured, leaving the other insured without coverage.

## **B. METHODS FOR RESOLVING MULTIPLE CLAIMS**

Courts have adopted various approaches when dealing with multiple claimant scenarios, and an insurer's obligation will vary depending upon the jurisdiction. The following are the most frequent approaches to address this prickly issue:

- Resolve claims on a pro rata basis: available limits are pro-rated based on the severity of the injuries sustained by the claimants.
- Resolve claims on a first-come-first-serve basis: claims are paid in the order that they are adjudicated or settled.
- Resolve as many of the claims as possible irrespective of the severity of the injury.
- Resolve the high-exposure and severe injury cases first, and then settle the remaining cases.
- Interpleader

### **PRO RATA**

When there are multiple claims and the policy limits are insufficient to compensate each claimant fully, some courts have applied the pro rata rule. This rule distributes the policy proceeds on a pro rata basis, in accordance with the amount of damage suffered by each claimant. Each claimant's portion of the pro rata recovery is limited by the maximum per person policy limit.

With this approach, an insurer may be at a disadvantage because it may have to wait to settle claims until after it receives confirmation that all claims have been submitted or until the statute of limitations has run. Under this approach, defense expenses may increase, reasonable settlement opportunities may pass, claims may be left unresolved, and an insured may be subject to greater excess exposure.

### **FIRST TO SETTLE**

There are two approaches to handling multiple claims that may exceed an insured's insurance limits: the first to judgment approach and the first to settlement. The first to judgment approach provides for distribution of policy proceeds based on priority of judgments. However, this approach is disfavored by most jurisdictions because it flies in the face of the public policy of encouraging settlements.

The first to settle approach, the favored method, recognizes that insurers can settle any number of multiple claims, even though the settlements would deplete or exhaust the policy limits. The theory is that if insurers were required to know of and to evaluate all potential claims against their insureds before settling any one claim, insurers would be discouraged from accepting reasonable settlement offers at an early stage of the litigation, which could potentially interfere with the public policy of encouraging settlements. For severely injured claimants, the first to settle approach may seem unfair. Claims involving claimants with severe injuries generally take longer to resolve because more time is needed to evaluate the injuries and to determine the ultimate prognosis and loss. Accordingly, settlements involving minor injuries can deplete a disproportionate amount of the available limits before any reasonable settlement negotiations can commence on a serious injury claim or claims.

The first to settle rule does not require an insurer to settle with the first claimant who presents an offer to settle within the policy limits. However, many courts have held that an insurer must act in good faith, reasonably, and without negligence when entering into settlements that deplete or exhaust the policy limits. Specifically, an insurer has a duty to act in good faith with respect to the disbursement of the proceeds. The facts and the circumstances of each case determine whether an insurer acted in good faith. Factors that a court will examine include 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.

### **RESOLVING HIGH EXPOSURE CLAIMS FIRST**

In some jurisdictions, an insurer may have to choose between exhausting the policy limits by (1) settling more claims by resolving smaller value claims first, or (2) settling one or more major claims with higher value and potential exposure. Under these circumstances, an insurer is well-advised to investigate all claims fully and determine the best method to enter into settlements and limit an insured's exposure to an excess judgment, especially when a wiser settlement approach could reduce or limit an insured's excess exposure.

### **INTERPLEADER**

Interpleader is a mechanism by which a party who possesses property or funds can bring together multiple claimants into a single judicial proceeding to have the court decide which claimants are entitled to the funds. Federal Rule of Civil Procedure 22(1) and 28 U.S.C. §§1335 (1976) provide for interpleader. In addition, most states have a rule of civil procedure regarding interpleader.

Federal procedure provides two distinct methods of invoking interpleader—"statutory" interpleader and "rule" interpleader—and their jurisdictional requirements vary. Under statutory interpleader, district courts have original jurisdiction over actions if: (1) the amount in dispute exceeds \$500; (2) there are two or more adverse claimants of diverse citizenship; and (3) the plaintiff deposits the money or property in dispute into the registry of the court or posts an adequate bond. 28 U.S.C. § 1335. Section 1335 has been uniformly construed to require only minimal diversity, that is, diversity of citizenship between two or more claimants, without regard to the circumstance that other rival claimants may be co-citizens. By contrast, rule interpleader pursuant to Federal Rule of Civil Procedure 22 is a procedural device only, and jurisdiction must therefore be proper under 28 U.S.C. § 1331 (federal question jurisdiction) or § 1332 (diversity jurisdiction).

An interpleader action typically involves two stages. First, the court must determine whether the plaintiff has properly invoked interpleader, including whether the court has jurisdiction over the suit, whether the stakeholder is actually threatened with double or multiple liability, and whether any equitable concerns prevent the use of interpleader. Once a court determines that interpleader is appropriate, the court may discharge the plaintiff from further liability, and may enter an injunction restraining the claimants from litigating related actions in state or federal court. 28 U.S.C. § 2361.

The benefits of the device to both the stakeholder and the claimants are substantial. It relieves the stakeholder from determining at his peril the merits of competing claims and shields the stakeholder from the prospect of multiple liability, and it gives the claimant, who ultimately prevails, ready access to the disputed fund. A stakeholder should not be obliged at its peril to determine which claimant has the better claim. Put another way, where a stakeholder is allowed

to bring an interpleader action, rather than choosing between adverse claimants, its failure to choose between the adverse claimants (rather than bringing an interpleader action) cannot itself be a breach of a legal duty.

However, filing an interpleader does not equate to immunizing an insurer against allegations of bad faith. An insured may still argue that interpleader benefits an insurer rather than the insured and that interpleader merely passes the buck from the insurer to the court and provides little protection for the insured. In fact, interpleader does not provide a mechanism for limiting an insured's excess exposure and therefore does not extinguish it.

Although bad faith may be alleged, there have been no cases in which bad-faith liability has been found by interpleading policy limits. The cases that have addressed the issue have held that merely interpleading funds does not constitute bad faith. *See Monumental Life Ins. Co. v. Lyons-Neder*, 140 F. Supp. 2d 1265, 1270 (M.D. Ala. 2001) (holding that a bad-faith claim for refusal to pay could not be maintained); *Schwartz v. State Farm Fire & Casualty Co.*, 88 Cal. App. 4th 1329 (Cal. App. 2d Dist. 2001); *Lehto v. Allstate Ins. Co.*, 31 Cal. App. 4th 60 (Cal. App. 2d Dist. 1994) (holding that an insurer's interpleader of policy limits did not constitute bad faith); *Bowers v. State Farm Mut. Auto. Ins. Co.*, 460 So. 2d 1288, 1290 (Ala. 1984) (holding that "absent some evidence to the contrary, the mere filing of an action of interpleader does not amount to evidence of bad faith dealing on its part").

### **C. CONCLUSION**

While properly handling claims involving multiple claimants may vary depending on the jurisdiction, there are some general practical considerations. Regardless of the approach, the following should be used as a guide in the multiple claimants-limited insurance contexts: (1) an insurer must investigate all claims fully; (2) an insurer should keep an insured fully informed of

all meaningful developments in the case, the amount of coverage remaining, potential exposure, and status of settlement negotiations; (3) the available policy limits should not be exhausted without attempting to settle as many claims as possible; and (4) an insurer should work to eliminate or to minimize potential excess judgments against an insured through fair and reasonable settlements.

The courts recognize the difficult situation that insurers face when trying to adjust multiple claims with limited insurance coverage. Given this scenario, the courts are willing to sanction an insurer's action in resolving some, but not all of the claims, as long as the settlement or settlements are reasoned and justifiable and the insurer can show that it attempted to minimize potential excess judgments against the insured.