Commentary

Multiple Claimants And Insufficient Policy Limits — Slicing Up The Pizza Pie Without Getting Burned!

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The Scenario

It's the Fourth of July and a large crowd is gathered outside a local bar to watch the fireworks. Suddenly, a car swerves from the parking lot and plows into the crowd. Numerous patrons are injured, some critically. Subsequent investigation reveals that the car's driver (owner) had been distracted when he dropped his cell phone while trying to answer a call. Claims begin to be asserted within weeks of the accident. At the time of the accident, the driver was insured with applicable limits (auto and umbrella) totaling $1 million. While unclear initially, it later becomes apparent that the policy limits will not be sufficient to settle all claims which will be presented.

As the above scenario illustrates, unique problems arise when an insured is facing multiple claims, liability is clear and the policy limits may be insufficient to settle all claims. How is the claims professional to handle this? Settle with the claimants on a "first come, first serve" basis? Attempt to "pro rate" settlements with all claimants? And how can bad faith exposure be avoided? Should the claims professional reach out to those who have not made a claim, and if so, when? Or should he/she reach out to those claimants who have made a claim but not filed suit? Does exhaustion of the policy limits through settlements terminate the duty to defend the insured? Should interpleader of the policy proceeds be considered? When is interpleader appropriate? And does interpleader terminate the insurer's duty to defend?

These and other issues presented by the multiple claimant-limited insurance scenario will be addressed by the authors herein and in a subsequent article.

There's More Than One Way To Slice The Pizza Pie

There is more than one appropriate way to handle the above dilemma. While it may necessitate careful analysis and continual re-assessment throughout the claims handling process, the mere fact that the insured has insufficient policy limits to satisfy all claims should not lead to bad faith exposure. An insurer, which keeps its insured's best interests in mind and responds in a manner reasonably calculated to protect those interests, cannot be faulted for being unable to satisfy all claims.

Numerous courts recognize that an insurer may settle fewer than all claims against its insured even though the settlements may deplete or exhaust the policy limits.[1] But knowing that you can divide up the pie without satisfying everyone still does not answer the question of how you slice it.

When confronted with a multiple claimant-limited insurance scenario, various potential approaches come to mind:

- Settle claims on a "first come first serve" basis.[2]
- Settle as many of the claims as possible (regardless of the comparative severity of injury or exposure).[3]
- Settle as many of the severe injury/high exposure claims as possible, with the remaining limits being utilized to settle the claims presenting less severe injuries/low exposure.
- Settle claims by *pro rating* available limits based on (among other factors) the severity of the injuries sustained by all of the claimants.[4]

While choosing an approach is the first step, successful execution is perhaps the more difficult journey. Regardless of the insurer's chosen path, claimants are often not willing to resolve their claims for offered amounts and don't care that there are other viable claims competing for limited policy proceeds. And, timing often plays a critical role. Smaller value claims are often readily disposed of early on in the claims process while the larger exposure claims may take a longer period of time to fully value.

Case Law Addressing How To Slice The Pizza Pie

Many of the cases addressing these issues involve relatively small policy limits of $15,000 to $100,000 with multiple claimants who have sustained severe injuries or death. In those situations, it is clear from the outset that, no matter how many claims are settled, it is likely that the policy limits will be insufficient to satisfy all claims. Nonetheless, these cases provide useful guidance to an insurer.

Many courts have held that an insurer must act in good faith, reasonably, and non-negligently in entering into settlements that deplete or exhaust the policy limits, requiring in some instances a comparative evaluation of the severity of the claims so that the best interests of the insured are served.[5]

An oft-cited decision upholding the insurer's settlement in the multiple claimant context is Texas Farmers Ins. Co. v. Soriano.[6] Soriano illustrates a Court's recognition that an insurer who acts in a manner to protect its insured's interests, attempting to slice the pie in more than one way but unable to satisfy all claims with the policy limits, nonetheless has acted in good faith.

In that case, Soriano crashed head-on into another car driven by Carlos Medina. Medina and his two children were injured and his wife was killed. Adolfo Lopez, a teenage passenger in Soriano's vehicle, was also killed. The Texas Farmers policy provided for limits of $10,000 per person and $20,000 per occurrence. Texas Farmers offered $20,000 to the Medinas, but they rejected this offer because they wanted to investigate Soriano's personal assets. The Medinas and Lopez's parents then sued Soriano. Shortly before trial, Texas Farmers settled the Lopez wrongful death claim for $5,000 and offered the remaining $15,000 to the Medinas, which was rejected.

The Medina claims went to trial and a verdict of $172,187 plus interest was entered in their favor. In exchange for a covenant not to execute the judgment, Soriano assigned his rights against Texas Farmers to the Medinas, who in turn sued Texas Farmers for negligence, gross negligence and breach of the duty of good faith and fair dealing. In a verdict against Texas Farmers, the Medinas were awarded over $500,000 in compensatory damages/interest and $5 million in punitive damages.

On appeal, the Texas Supreme Court concluded that there was no evidence that Texas Farmers was negligent or breached a duty of good faith and fair dealing. The court applied the Texas bad faith standard, noting that insurers must "exercise that degree of care and diligence which an ordinary prudent person would exercise in the management of its own business in responding to settlement demands within policy limits."[7]

The court held that an insurer can enter into a reasonable settlement with one of the claimants, despite the fact that the settlement reduces the available proceeds for remaining claimants.[8] The insurer could not be liable for negligently failing to settle the Medina claims unless there was evidence that it negligently rejected a settlement demand within the policy limits or the $5,000 settlement with Lopez was unreasonable, neither of which occurred.[9]

In Soriano, the insurer carefully considered the possible approaches and first attempted to settle four of the five claims with the full policy limits, which would have left one death claim uncompensated. When that offer was rejected and as the case headed towards trial, the insurer settled one death claim for a quarter of the policy limits, offering the remaining policy limits to the four claimants. While diminishing the policy limits, the settlement was a reasonable one which protected the insured's interests.

Regardless Of How You Slice It, Settlements Should Be Reasoned And Justifiable

Insurers will undoubtedly face conflicting choices in the multiple claimants-limited insurance context. For example, an insurer may have to choose between exhausting the policy limits by settling many smaller value claims or one or more major claims with higher value and potential exposure.

The most difficult situation may be when large value demands are made by multiple claimants which individually could be satisfied within the policy limits, but as a group cannot be. Under these circumstances, the insurer is well served to fully investigate all claims and determine how best to limit the insured's liability while not indiscriminately entering into settlements, particularly where the insured's exposure to an excess judgment could have been reduced by a wiser settlement package.[10]

Regardless of the approach, at least one court has concluded that the following should guide an insurer in the multiple claimants-limited insurance context: (1) the insurer must fully and non-negligently investigate all claims; (2) the insurer should keep the insured informed of the claims negotiation and settlement process; (3) policy limits should not be exhausted without attempting to settle as many claims as possible; and (4) the insurer should work to eliminate or minimize possible excess judgments against the insured through reasoned claims settlements.[11]

The Insured Should Be Notified When There May Not Be Enough Pie To Go Around

Most liability policies give the insurer the option to settle a claim or suit at the insurer's discretion and do not necessarily require the insurer to provide notice to the insured of settlement demands or require the insured's consent to settle. Nonetheless, as a general matter, an insurer is well served in the multiple claimants-limited insurance context to keep the insured apprised of the diminishing limits and the settlement efforts. While doing so may not prevent a bad faith claim, it certainly affords an insured an opportunity, if so inclined, to contribute toward a settlement in order to protect against potential uninsured (excess) exposure and/or offer its suggestions concerning the distribution of the limited funds.

In some instances, courts have found bad faith or breach of contract where an insurer failed to notify the insured of a policy limits settlement or settlement demand in the multiple claimants-limited insurance situation, particularly where notice to the insured might have impacted an excess judgment.

For example, a court held that an insurer acted negligently and in breach of its duty of good faith by failing to advise the insured in a multiple claimants situation of a seriously injured claimant's policy limits demand.[12] In that case, the insured hit a car driven by Levier head on. Levier was seriously injured and a passenger in the insured's vehicle, Cartwright, was also injured. Aetna informed its insured that the claims against him would likely exceed the $100,000 policy limits, and also determined that the insured was 95-100% responsible for the accident.[13] Aetna did not however advise the insured that its estimated value of Levier's claim was over $2 million and the value of Cartwright's claim was almost $50,000.

Aetna decided to offer both Cartwright and Levier $25,000 to settle. Although Levier offered to settle for the policy limits, Aetna did not respond to or advise the insured of Levier's demand.[14] Cartwright accepted the offer and Aetna thereafter interpleaded the remaining policy limits.

The Kansas Court of Appeals concluded that Aetna's $25,00 offer to each claimant was supported by established law and that Aetna's settlement of the Cartwright claim was made in good faith and in the insured's best interests. However, the Court concluded that Aetna had breached its good faith duty in its handling of the settlement negotiations by failing to advise the insured of its high value of Levier's claim and of Levier's $100,000 settlement offer and by failing to invite the insured to contribute to the settlement.[15] Aetna, therefore, had failed to treat the offer with the

same degree of care it would have used in representing its own interests, "acting with indifference towards its insured's ultimate financial liability."[16]

Aside from notice to the insured, an insurer may also wish to consider if and when claimants should be notified of the diminishing policy limits and whether to seek their input in dividing up the pie.

Should Claimants Be Notified Of The Limited Number of Slices And, If So, When?

A number of courts have considered whether an insurer must notify claimants of settlements that diminish or deplete the policy limits. For example, in one case, the Illinois Appellate court suggested that there are some instances in which a liability insurer may owe a duty of good faith to the various claimants, to the extent of notifying them, at a minimum, of the proposed settlement negotiations.[17] Nevertheless, the court held there were no facts in that case justifying a notice requirement because, absent an offer to settle, the insurer could reasonably conclude that it might have a good defense to plaintiff's claim.[18] The court therefore upheld a settlement that depleted the policy limits in a wrongful death case where fewer than all claimants released the insured, even though the non-settling claimant was not notified of the settlement negotiations.

In a handful of cases, courts have indicated that claimants should have been notified that policy limits would be exhausted by settlements, but this requirement was imposed primarily where the insurer continued to deal with the claimants.[19] For example, in one case, the Supreme Court of Kansas identified three options an insurer could have chosen to avoid bad faith, one being to notify all potential claimants that the value of the claims would likely exceed policy limits and seeking their collective participation in an attempt to dispose of the remaining proceeds.[20] The Court stated that this alternative was preferable where the claimants are available and litigation may be avoided.[21]

In contrast, the Court of Appeals of Georgia upheld a settlement in favor of a severely injured claimant for $900,000, which left only $100,000 of the policy limits for the other claimant. The court concluded that the settlement would not have been in bad faith even if the insurer had settled without conferring with the other claimant.[22]

In appropriate cases involving multiple claimants and clear liability on the part of the insured with damages in excess of the policy limits, many courts have looked favorably upon an insurer's attempts to obtain all necessary information and meet with claimants in an effort to achieve a global policy limits settlement or at least reach some consensus on distribution of the policy limits, even if the insurer's efforts ultimately fail.

In one such case, only $25,000 in policy limits were available to satisfy two claims by pedestrians hit by the insured's vehicle (one of whom was killed and the other severely injured). The First Circuit Court of Appeals concluded that the insurer's settlement offer that included a 50-50 split of the insurance proceeds was in good faith.[23] The proposed settlement was accepted by the husband of the decedent, but the injured eleven year old claimant who lost both legs in the accident refused to accept the $12,500 settlement offer, later sued the insured, and won a large verdict which the insured was unable to pay.[24] The claimant agreed that it would not collect on the judgment in exchange for an assignment of a potential bad faith claim against the insurer, and subsequently sued the insurer for bad faith in handling the settlement negotiations.[25] In rejecting the bad faith argument, the First Circuit noted that the insurer had met with counsel for both claimants and sought suggestions as to how to divide the limited funds before the offers were made.[26]

In another case, an insurer was faced with two claims, one for injury and one for death, with total policy limits of $300,000.[27] In an attempt to ascertain a realistic value of the worth of both claims, the insurer investigated and gathered information from claimants' counsel regarding claimants' age, marital status, survivors, employment and health information.[28] The insurer also advised the claimants that the total policy limits were available on a "global basis," and arranged and attended mediation with the claimants.[29] Following the claimants' failure to agree as to distribution of the policy limits, the insurer tendered the policy limits to the decedent's estate.[30] Having clearly exercised good faith in investigating and attempting to settle both claims within the policy limits, the court upheld the settlement payment to the estate and dismissed the bad faith claim against the insurer.[31]

Accordingly, while not a policy requirement, an insurer may wish, in appropriate circumstances, to notify claimants that the value of the claims may exceed policy limits and seek their input in attempting to reach a global and equitable distribution of the limited policy proceeds.

Practical Tips And Considerations

While proper handling of the multiple claimant-limited insurance scenario necessarily requires a review of applicable common and statutory law in the governing jurisdiction, some general considerations emerge:

- Identify all claimants and potential claimants.
- Promptly respond, in writing, to all communications from the insured and claimants.
- Review the policy language governing the insurer's duty to defend and right to settle.
- Obtain from defense counsel an evaluation and recommendation regarding the settlement potential of all claims, including all pending demands and lawsuits.
- Promptly notify the insured, in writing, that policy limits may be exceeded due to the nature and extent of claims involved and insured's potential liability if all claims do not settle within policy limits. Suggest that the insured may want to retain independent counsel to provide it with advice concerning opportunities to contribute to settlements to avoid uninsured excess exposure when the policy limits are insufficient to satisfy all claims.
- Keep the insured periodically advised (in writing) of the claims evaluation, negotiations and settlement process, encouraging their response to the strategy to eliminate or minimize possible excess judgments and/or to settle as many claims as possible.
- While perhaps not legally required, consider notifying claimants (in writing), at the appropriate time, that the value of the claims may very well exceed policy limits. Consider participation by the claimants (and the insured) in settlement meeting(s) or mediation in an attempt to disburse available insurance proceeds in a global, equitable process with a release for the insured.
- Document the file with information demonstrating a full and complete investigation and evaluation of the multiple claims, including but not limited to medical evidence showing the nature and extent of injury(ies), a weighing and analysis of the competing claims, factual evidence and defense counsel's evaluation/recommendations as to claim values, possibilities for contribution from other defendants, etc. This will demonstrate that any settlements reached were reasonable and not an indiscriminant squandering of policy proceeds.
- Work to eliminate or minimize possible excess judgments against the insured through reasoned settlements of those claims which present significant exposure and/or to attempt to settle as many claims as possible with the remaining policy limits.
- If efforts at a global settlement are unsuccessful, review applicable interpleader law/rules and consider interpleading funds into court, where an option. (This will be further addressed in a subsequent article by the authors).
- As an overarching consideration, bear in mind that the insurer will likely have to demonstrate that it exercised the same degree of care and diligence as a person of ordinary care would exercise in the management of his or her own business.

Properly documenting the claims file will affirmatively demonstrate that the insurer used the same degree of care it would have used if it were representing its own interests alone, thereby showing its good faith efforts to settle and minimize uninsured exposure to its insured.

Endnotes

1. See *Too Many Claimants, Too Little Money Revisited*, 14 No. 8 Bad Faith L. Rep. 151 (1998) ("[T]he great weight of authority accords the insurer wide discretion in settling multiple claims. If the insurer settles with one claimant in good faith, the settlement reduces the limit of its liability to the remaining claimants, who may not complain that the insurer favored the settling claimant over them.").

2. A majority of jurisdictions permits this approach. See e.g., Voccio v. Reliance Ins. Co., 703 F. 2d 1, 2 (1st Cir. 1983) (insurer can settle on "first come, first served" basis); Hartford Cas. Ins. Co. v. Dodd, 416 F. Supp. 1216 (D.Md. 1976); Harmon v. State Farm Mutual Auto. Ins. Co., 232 So. 2d 206, 207-08 (Fla. App. 1970); Allstate Ins. Co. v. Evans, 200 Ga. App. 713, 409 S. E. 2d 273, 274 (Ga. App. 1991); State Farm MutualAuto Ins. Co. v. Murphy, 38 Ill. App. 3d 709. 348 N. E. 2d 491, 493-4 (Ill. 1976); Bennett v. Conrady, 180 Kan. 485, 305 P. 2d 823, 827-28 (Kan. 1957); Holtzclaw v. Falco, Inc., 355 So. 2d 1279, 1286-87 (La. 1978); Luguori v. Allstate Ins. Co., 76 N.J. Super. 204, 184 A. 2d 12, 16-17 (1962); Negron v. Eveready Ins. Co., 53 A. D. 2d 815, 385 N.Y.S. 2d 87, 88, appeal dism'd, 40 N.Y. 2d 970, 359 N. E. 2d 429 (1976); Alford v. Textile Ins. Co., 248 N.C. 224, 103 S.E. 2d 8, 13 (N.C. 1958); Scharhitzki v. Bienenfeld, 534 A.2d 825 (Pa. Super. 1987); Texas Farmers Ins. Co. v. Soriano, 881 S.W.2d 312 (Tex. 1994).

3. See Farinas v. Florida Farm Bureau General Ins. Co., 850 So.2d 555 (Fla. App. 2003) (insurer should attempt to settle as many claims as possible within the policy limits, but avoid indiscriminately settling claims where the insured's excess liability might be minimized through settlement).

4. See e.g., Allstate v. Ostenson, 713 P.2d 733, 735 (Wash. 1986). For cases involving multiple suits against the insured, See Burchfield v. Bevans, 242 F.2d 239 (10th Cir. 1957); State Farm Mut. Auto Ins. Co. v. Hamilton, 326 F.Supp. 931 (D.S.C. 1971); Century Indemnity Co. v. Kofsky, 161 A. 101 (Conn. 1932); Underwriters for Lloyds of London v. Jones, 261 S.W.2d 686 (Ky. 1953). For cases involving multiple claimants in the same suit, see e.g., Sheehan v. Liberty Mut. Fire Ins. Co., 258 So. 2d 719 (Ala. 1972); Johnson v. State, 450 So.2d 1311 (La. 1984); State Farm Mut. Auto Ins. Co. v. Sampson, 324 So.2d 739 (Miss. 1975); Christlieb v. Luten, 633 S.W.2d 139 (Mo. App. 1982); Wasserman v. Glen Falls Ins. Co., 240 N.Y.S.2d 917 (N.Y. App. Div. 1963); Wondrowitz v. Swenson, 392 N.W.2d 449 (Wis. Ct. App. 1986).

5. See e.g., Williams v. Infinity Ins. Co., 745 So.2d 573, 576-77 (Fla. 5th DCA 1999) (insurer acted reasonably by not exhausting its policy limits when paying two of several claimants); Holtzclaw v. Falco, Inc., 355 So.2d 1279, 1286-87 (La. 1978); Voccio v. Reliance Ins. Cos., 703 F.2d 1, 3 (1st Cir. 1983) (insurer cannot be liable by virtue of its division of insurance proceeds among claimants unless its actions were "highly unreasonable, reckless or in bad faith"); Merritt v. New Orleans Pub. Serv., 421 So.2d 1000, 1001 (La. Ct. App. 1982) ("insurer may enter into reasonable, good faith settlements even though such settlements exhaust or diminish the proceeds available to other claimants"); Castoreno v. Western Indem. Co., 213 Kan. 103, 515 P.2d 789, 795 (1973) (insurer may settle part of multiple claims arising from negligence of its insured even though such settlements deplete or exhaust the policy limits if it acts in "good faith"). See generally Peckham v. Continental Cas. Ins. Co., 895 F.2d 830, 835 (1st Cir. 1990).

6. 881 S.W. 2d 312 (Tex. 1994).

7. Id. at 314.

8. Id. at 316.

9. Id.

10. See Levier v. Koppenheffer, 19 Kan. App. 2d 971, 879 P.2d 40 (1994) (holding that insurer acted in bad faith by settling a smaller claim for the policy limits, leaving the insured exposed to a damage claim that exceeded $2 million in the insurer's own estimation, where the larger claim could have been settled for the policy limits); DeWalt v. Ohio Cas. Ins. Co., 513 F.Supp.2d 287 (E.D. Pa. 2007) (under Pennsylvania law, declining to offer limits to one claimant before obtaining information on other claimants did not constitute bad faith); General Security National Ins. Co. v. Marsh, 303 F. Supp. 2d 1321 (M.D. Fla. 2004) (court upheld insurer's settlement in the multiple claimants context where, after investigation, negotiation, and unsuccessful mediation of two claims, the insurer paid the policy limits to settle a wrongful death claim, which presented a greater risk of excess judgment, leaving a personal injury claim representing less exposure unpaid).

11. See Farinas v. Florida Farm Bureau General Ins. Co., 850 So.2d 555 (Fla. App. 2003) (insurer should

attempt to settle as many claims as possible within the policy limits, but avoid indiscriminately settling claims where the insured's excess liability might be minimized through settlement). See also Safeco Ins. Co. v. Ritz, 2006 WL 119991 (E.D. Ky. 2006).

12. Levier v. Koppenheffer, 879 P.2d 40, 45 (Kan. App. 1994).

13. Id. at 973.

14. Id.

15. Id. at 980.

16. Id. See also McKinley v. Guaranty Nat. Ins. Co., 144 Idaho 247, 159 P.3d 884 (Idaho 2007).

17. Haas v. Mid America Fire & Marine Ins. Co., 35 Ill.App.3d 993, 343 N.E.2d 36 (Ill.App. 3 Dist. 1976).

18. Id. at 997.

19. See Hartford Casualty Ins. Co. v. Dodd, 416 F. Supp. 1216 (D. Md. 1976) (insurer wrongfully discriminated in favor of one named insured against other claimants under personal injury protection (PIP) coverage and failed to advise claimants that PIP benefits would be exhausted if they did not promptly file claims); State Farm Ins. Co. v. Credle, 228 A.D.2d 191, 643 N.Y.S.2d 97 (App. Div. Dept. 1996) (insurer may have acted negligently, although not in bad faith, by exhausting the policy limits on behalf of other claimants after the non-settling claimant filed her claim, and in continuing to deal with her after exhaustion of the policy limits).

20. Farmers Ins. Exchange v. Schroop, 222 Kan. 612, 567 P.2d 1359 (Kan. 1977).

21. Id. at 621.

22. Miller v. Interlocal Risk Management Agency, 232 Ga. App. 231, 501 S.E. 2d 589 (1998).

23. Voccio v. Reliance Ins. Co., 703 F.2d 1 (1st Cir. 1983).

24. Id. at 2.

25. Id.

26. Id. at 3.

27. General Security National Ins. Co. v. Marsh, 303 F. Supp. 2d 1321 (M.D. Fla. 2004).

28. Id. at 1323.

29. Id.

30. Id.

31. Id. at 1326. ■