# Bringing "Bad Faith Refusal to Settle" Claims Against Insurers

By G. Grant Dixon III

*If the plaintiff wins a favorable verdict, can he or she collect on the judgment even though it exceeds the amount of the insurance held by the defendant? If the insurance company refused in bad faith to settle within the policy limits, the answer should be yes. This article explores the issue from a plaintiff's perspective.*

## I. Duty-to-Settle Scenario

On New Year's morning, 1999, Peggy and Patty Plaintiff were stopped at an intersection waiting for the light to change to green. They had just graduated from college and both started working for the same company as flight attendants. As they waited, an overweight semi tractor-trailer driven by David Driver plowed into the rear of Peggy and Patty's car. Peggy was rendered a quadriplegic with nearly $1 million in medical bills at the time of trial. Patty had severe, but less serious, injuries. Her medical bills were about $40,000.

Through discovery you as counsel for the plaintiff have learned that the total insurance available from the truck, trailer, and driver's insurers is $2 million. You made a demand for the entire amount. The adjuster and defense attorney rejected the demand and the case went to trial.

The jury says they have a verdict. The foreperson stands to read it: "We the jury find in favor of PEGGY PLAINTIFF and PATTY PLAINTIFF and against DAVID DRIVER and MEGA TRUCKING in the amount of $5 million."

What happens next? This is scenario is the classic "duty to settle," also known as the "third-party bad faith refusal to settle," action.[1] In protecting the interests of your clients, you must know how to secure the right to damages in excess of the policy amount from the insurance company. This article will discuss the steps necessary to ensure that right of recovery and to obtain punitive damages as well.

## II. Historical Confusion

### *A. Early History*

Early on, unscrupulous adjusters would refuse to settle a liability claim for policy limits unless the insured contributed some amount to the settlement. The insured, facing judgment in excess of the policy amount, would be forced to contribute money to resolve the claim because his or her total exposure was far greater than the policy limits. On the other hand, the insurance company had contractually limited exposure and virtually no risk at trial.[2]

Moreover, the policyholder had no contractual remedy. Courts reasoned that the nature of the "breach" for which the insured sought to hold the insurer liable was vague at best, and the policies never specifically defined the insurer's duty when responding to settlement offers. Judges would dutifully examine the insurance contract and agree that the contract clearly spelled out the limit of the insurance company's liability — the policy limit and nothing more. The innocent (and injured) plaintiff was left holding a judgment only valued at the amount of the defendant's worth. From the plain-

1. "Lawyers and judges tend to use the term 'third-party bad faith' loosely to refer to bad faith cases involving liability insurance policies....To be accurate, however, one should reserve the term 'third-party bad faith' for bad faith cases based on a liability insurer's failure to accept a third-party claimant's offer to settle his claim against the insured." Stephen Ashley, *Bad Faith Actions, Liability and Damages*, § 3.01 (Clark Boardman) (Nov 1996) (*"Bad Faith"*).

2. *Bad Faith*, §2.02; see also Wm. M. Shernoff, Sanford M. Gage, Harvey R. Levine, *Insurance Bad Faith Litigation* (Mathew Bender) (Sept 1996).

tiff's perspective, something more was needed.

Enter tort law. Courts created a new tort, one that enabled insureds to sue their insurers for breach of the fiduciary responsibility owed them. The tort was loosely termed "bad faith." It was really a recognition of the duty of every insurer to agree to negotiate with the interests of its own and its insured in mind.

### *B. Recognition of Tort in Illinois*

The first Illinois bad-faith case[3] was *Olympia Fields Country Club v Bankers Indemnity Ins. Co.*[4] There, Alice Halladay was injured at the club and sued for those injuries. The jury returned a verdict in plaintiff's favor. The club paid the amount in excess of the policy and then sued its insurance company for failing to settle the claim within the policy limits.[5] The evidence revealed that Halladay's attorney offered to settle the case within the policy limits before, during, *and after* the verdict, but those offers were all refused.[6] After reviewing the law of its sister states,[7] the court adopted the idea of bad-faith refusal to settle.[8]

Later rulings by the Illinois Appellate Court have created a confusing body of law. Some appellate districts ruled that the tort of bad faith did not exist.[9] Others assumed the tort existed but was completely preempted by 215 ILCS 5/155.[10] Still others concluded that section 155 preempted punitive damage claims but not claims for compensatory damages.[11] Many more thought that if the conduct alleged was nothing more than unreasonable and vexatious, section 155 preempted the claim.[12] Confusion reigned, and the Illinois Supreme Court stepped in.

## III. *Cramer* — Confusion Abolished, Duty Established

The Illinois Supreme Court eliminated much of the confusion in this area with *Cramer v Insurance Exchange Agency.*[13] In that case, Mr. Cramer's home was burglarized just three days after a home owner's policy cancellation went into effect. The insurance company denied coverage and the pro se plaintiff filed suit against his own insurer. The defendant insurance company filed a motion for summary judgment, claiming the case was time barred and that the plaintiff had no coverage because the policy had lapsed.

After denial of summary judgment, the insurance company appealed. The appellate court certified two questions for interlocutory appeal:

(1) Whether section 155 of the Illinois Insurance Code (215 ILCS 5/155 (1994)) preempts a common law fraud cause of action against an insurance company for its alleged unreasonable conduct in denying an insurance claim; and

(2) Whether a limitation provision of an insurance policy stating that "[n]o action can be brought unless the policy provisions have been complied with and the action is started within one year after the date of loss" is applicable to a common law fraud cause of action against an insurance company for its allegedly unreasonable conduct in denying an insurance claim.

The supreme court seized this opportunity to clarify much of the law of bad faith, though nearly all of it is dicta.[14] The *Cramer* court stated that in third-party bad-faith cases (i.e., where the insurance company is being sued by someone other than its insured), insurers do have a duty to act in good faith and respond to offers of settlement.[15] If the insurer does not act in good faith in responding to those settlement offers, the insurance company can be liable for the full amount of the judgment against the policy holder, without regard to the policy limits.[16]

The basis for this "duty to settle" arises because the policyholder has relinquished defense of the suit to the insurer.[17] Insurance is a fiduciary rela-

3. This reference pertains only to third-party cases. For purposes of this article, the term "bad faith" applies to third-party cases only.

4. 325 Ill App 649, 60 NE2d 896 (1st D 1945).

5. Id, 325 Ill App at 651.

6. Id, 325 Ill App at 653-54.

7. Id, 325 Ill App at 660-62.

8. Id, 325 Ill App at 676-77. In spite of the victory, errors in two of the jury instructions employed by the trial court in the bad faith trial necessitated an new trial. Id.

9. See *Buais v Safeway Insurance Co.*, 275 Ill App 3d 587, 656 NE2d 61 (1st D 1994); *Perfection Carpet, Inc. v State Farm Fire & Casualty Co.*, 259 Ill App 3d 21, 630 NE2d 1152 (1st D 1993); *Tobolt v Allstate Ins. Co.*, 75 Ill App 3d 57, 393 NE2d 1171 (1st D 1979); *Debolt v Mutual of Omaha*, 56 Ill App 3d 111, 371 NE2d 373 (3d D 1978); *Ellis v Metropolitan Prop. & Liability Ins. Co.*, 600 F Supp 1 (SD Ill 1982); *Strader v Union Hall, Inc.*, 486 F Supp 159 (ND Ill 1980).

10. For a discussion of section 155, see section III of this article. See *Emerson v American Bankers Insurance Co. of Florida*, 223 Ill App 3d 929, 585 NE2d 1315 (5th D 1992); *Calcagno v Personalcare Health Management, Inc.*, 207 Ill App 3d 493, 565 NE2d 1330 (4th D 1991); *Hoffman v Allstate Insurance Co.*, 85 Ill App 3d 631, 407 NE2d 156 (2d D 1980); *Kohlmeier v Shelter Insurance Co.*, 170 Ill App 3d 643, 525 NE2d 94 (5th D 1988); *W.E. O'Neil Construction Co. v National Union Fire Insurance Co.*, 721 F Supp 984 (ND Ill 1989); *American Dental Assn. v Hartford Steam Boiler Inspection & Insurance Co.*, 625 F Supp 364 (ND Ill 1985); *Scheinfeld v American Family Mutual Insurance Co.*, 624 F Supp 698 (ND Ill 1985); *UNR Industries, Inc. v Continental Ins. Co.*, 607 F Supp 855 (ND Ill 1989).

11. *Roberts v Western-Southern Life Insurance Co.*, 568 F Supp 536 (ND Ill 1983); *Kelly v Stratton*, 552 F Supp 641 (ND Ill 1982); *Calcagno v Personalcare Health Management, Inc.*, 207 Ill App 3d 493, 502, 565 NE2d 1330 (4th D 1991); *McCall v Health Care Serv. Corp.*, 117 Ill App 3d 107, 112, 452 NE2d 893 (4th D 1983); *Hoffman v Allstate Ins. Co.*, 85 Ill App 3d 631, 635, 407 NE2d 156 (2d D 1980).

12. *Mazur v Hunt*, 227 Ill App 3d 785, 592 NE2d 335 (1st D 1992); *Combs v Insurance Co. of Illinois*, 146 Ill App 3d 957 (1st D 1986); *Kush v Am. States Ins. Co.*, 853 F2d 1380; *Zakarian v Prudential Insurance Co. of America*, 652 F Supp 1126 (ND Ill 1987); *Bageanis v American Bankers Life Assurance Co.*, 783 F Supp 1141 (ND Ill 1992); *York v Globe Life & Accident Insurance Co.*, 734 F Supp 340 (CD Ill 1990).

13. 174 Ill 2d 513, 675 NE2d 897 (1996).

14. The narrow holding of the *Cramer* court was threefold. First, the court held that section 155 does not preempt separate and independent causes of action in tort provided they are not covered by the rubric "unreasonable and vexatious." Second, the court ruled that there is no independent tort known as bad faith. Third, the facts of the case showed the cause of action by Cramer was time barred.

15. *Cramer*, 174 Ill 2d at 525, citing *Krutsinger v Illinois Cas. Co.*, 10 Ill 2d 518, 527, 141 NE2d 16 (1957).

16. Id, citing *MidAmerica Bank & Trust Co. v Commercial Union Insurance Co.*, 224 Ill App 3d 1083, 1087, 587 NE2d 81 (5th D 1992); *Phelan v State Farm Mutual Automobile Insurance Co.*, 114 Ill App 3d 96, 104, 448 NE2d 579 (1st D 1983); *Edwins v General Casualty Co.*, 78 Ill App 3d 965, 968, 397 NE2d 1231 (4th D 1979); *Scroggins v Allstate Insurance Co.*, 74 Ill App 3d 1027, 1029, 393 NE2d 718 (1st D 1979).

17. *Cramer*, 174 Ill 2d at 525.

## ABOUT THE AUTHOR

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tionship.[18] The policyholder-defendant depends upon the insurer to conduct the defense properly.[19] By allowing the insurance company to hire the attorney and in effect guide the defense of the case, the insurance company must act in good faith.[20] When it violates that duty, the insurer is guilty of acting in bad faith.[21] But even with the duty, without the knowledge of how to show a violation of that duty, the quest for sanctions will be fruitless.

### IV. Establishing Bad Faith

A prerequisite to any bad-faith-refusal-to-settle claim is the plaintiff's willingness to settle.[22] This plaintiff can express this willingness in a number of ways.

*A. Pre-trial*

One of the best known pre-trial ways to establish willingness to settle is to send a "bad faith" letter. This letter should contain a brief recitation of the facts, the liability, and damages. It should be drafted in simple language so it can be understood by the insurance company's adjuster, the defense attorney, and (most importantly) the defendant. It should also contain an expression of a willingness to settle the case within the policy limits for a period of time.

The bad-faith letter should not be objective. The role of the letter is to inform the insurance company, the lawyer, and the defendant that you have a strong case but are willing to be reasonable. In drafting the letter, remember that this will be Exhibit 1 in any subsequent bad-faith case.[23] What will the jury want to know? How can you make the jury see that your client is entitled to the damages in excess of the policy? These questions should be addressed in your bad-faith letter.

A second and less common way to express willingness to settle is to make a phone call to the defense attorney. Inform him or her that the case can be settled within the policy amounts. Explain why you should win and why your client's case is worth more than the policy. Documenting this conversation in your file or following up with a letter should be enough to document bad faith.

*B. Trial Settlement Conferences*

Assuming event there eventually is a bad faith case, it may be presided over by the judge that tried the underlying action. Consequently, the trial judge must understand that you are willing to be reasonable. The court should engage in settlement discussions with both parties. Explain your version of the case to the trial judge and try to persuade him or her that the case is worth the policy amount or more.

### V. Post-Trial

Assume that you sent a "bad-faith" letter. You had a settlement conference with the trial judge but he or she could not settle the case. You succeeded at trial and obtained a $5 million verdict. Now what? How do your clients obtain the full recovery?

*A. Assignment*

The first thing needed is an assignment of the bad-faith case from the insured defendant. It is the *insured's* cause of action based on the insurance company's breach of its fiduciary responsibility to him or her.[24] He or she must assign this cause of action to you before you can proceed.[25]

The insured has a strong motivation to do so. You hold a valid judgment worth millions. You can provide documentation proving that you were willing to be reasonable and that the insurance company was simply trying to cover its own hide, not its insured's. He or she will gladly forego liability in exchange for the assignment. Parenthetically, the insured does not need to pay off the judgment in order to assign the case to you and your client.[26]

*B. Filing Suit, Elements of the Cause of Action*

Now you have a cause of action, which lies in negligence but is based on a breach of a contract.[27] The case can be filed in one of two ways: either a separate cause of action based in tort or an ancillary proceeding in the same case.[28] In either event, there are several elements to the bad-faith case that should be alleged:

a. Demand on the insurer to pay the policy amount was made.[29]

b. There was a duty to inform insured of offers and exposure.

c. There was a failure to inform the insured of his exposure (breach of duty).[30]

**"One of the best known pre-trial ways to establish willingness to settle is to send a 'bad faith' letter....It should be drafted in simple language... and....contain an expression of a willingness to settle the case within the policy limits for a period of time."**

18. The insurer owes neither you as the plaintiff's lawyer nor your plaintiff any duty of any kind. *Yelm v Country Mut. Ins. Co.*, 123 Ill App 2d 401, 259 NE2d 83 (3d D 1970).

19. *Cramer*, 174 Ill 2d at 525.

20. *Mid-America Bank & Trust Co. v Commercial Union Ins. Co.*, 224 Ill App 3d 1083, 587 NE2d 81 (5th D 1992); *Cernocky v Indemnity Ins. Co.*, 69 Ill App 2d 196, 216 NE2d 198 (2d D 1966). That does not mean paramount to, but merely equal to, its own. *Adduci v Vigilant Ins. Co., Inc.*, 98 Ill App 3d 472, 424 NE2d 645 (1st D 1981).

21. *Powell v Prudence Mut. Cas. Co.*, 88 Ill App 2d 343, 232 NE2d 155 (1st D 1967) (insurer in refusing to settle case within maximum policy limits is held to a standard of reasonable conduct and avoidance of fraud, negligence, and/or bad faith).

22. *Brocato v Prairie State Farmers Ins. Assn.*, 166 Ill App 3d 986, 520 NE2d 1200 (4th D 1988). Nor does the insurance company have a duty to initiate the settlement negotiations. *Stevenson v State Farm Fire & Cas. Co.*, 257 Ill App 3d 179, 628 NE2d 810 (1st D 1993); *Haas v Mid America Fire & Marine Ins. Co.*, 35 Ill App 3d 993, 343 NE2d 36 (3d D 1976).

23. An example of a bad faith letter is attached as Exhibit B. The trier of fact in a "bad faith refusal to settle" case will consider all evidence of bad faith including letters, testimony of the parties, adjusters, and attorneys. See *Cernocky v Indemnity Ins. Co. of North Amer.*, 69 Ill App 2d 196, 216 NE2d 198 (2d D 1966).

24. See *Haas*, 35 Ill App 3d at 996 (3d D 1976) (sole basis for recovery by insured is an action for bad faith).

25. *Scroggins v Allstate Ins. Co.*, 74 Ill App 3d 1027, 393 NE2d 718 (1st D 1979). Because the insurance company owed the plaintiff no duty at all, the case must be assigned before you can file suit. *Kennedy v Kiss*, 89 Ill App 3d 890, 894, 412 NE2d 624 (1st D 1980) (first party case).

26. *Browning v Heritage Ins. Co.*, 33 Ill App 3d 943, 947, 338 NE2d 912 (2d D 1975).

27. Id, 33 Ill App 3d at 946.

28. Because the case is based on a breach of the fiduciary responsibility and arises out of an oral or implied contract, the statute of limitation is five years, not two. *McCarter v State Farm Mut. Auto. Ins. Co.*, 130 Ill App 3d 97, 473 NE2d 1015 (3d D 1985).

29. *Van Vleck v Ohio Cas. Ins. Co.*, 128 Ill App 3d 959, 471 NE2d 925 (3d D 1984) (failure to allege demand to settle within policy limits was fatal to complaint for excess).

30. *Bad Faith*, § 3.03 (cited in note 1).

d. The insurance company incompetently or dishonestly evaluation of the claim.

e. The defendant rejected pre-trial and/or trial settlement offers within the policy.

f. There was a verdict in excess of the policy amount.

g. There was demand on the insurer to pay policy and excess.

h. There was refusal of the insurer to pay policy and/or excess.

i. The plaintiff suffered specified damages.

Liability of the insurer is not per se.[31] And just because you prevailed at trial and obtained a verdict in excess of the policy amount does not mean you win in bad faith.[32] The conduct of the insurer must be vexatious and unreasonable.[33] To show that, you need some discovery.

*C. Discovery*

Your discovery should be targeted to reveal whether the refusal to settle was an isolated incident, an action without discernable rational basis,[34] or a pattern of conduct. To do that, start with the written discovery. Obtain all the communications sent to and from the insured;[35] any communications between the insurance company and the defense attorney regarding settlement become relevant; and, any communications or settlement discussions inside the insurance company such as evaluations and reviews are important.[36] Ultimately, the trier of fact must ask itself whether the insurer holds the insured's interests as high as their own.[37]

If you need to, depose the insurance company adjuster(s) and the defense attorney.[38] Establish that they received your bad-faith letters and other settlement information but chose to disregard it.

Finally, search to determine whether there have been any other bad-faith cases against the insurance company. The more you find, the better your chances of obtaining more significant damages.

## VI. Punitive Damages

Punitive damages are, by definition, exemplary damages. Therefore, to get them, you must show outrage, spite, malice, or an evil motive on the part of the insurer and towards the insured.[39] The level of conduct is high and more stringent than that to show compensatory damages.[40] It is on a higher plane that mere bad faith.

*A. Factors*

Several factors weigh in favor of punitive damages in the normal bad-faith case. The logical first step is to look at what the insurance company told the insured. Lies, half-truths, and misstatements will weigh heavily in favor of the punitive award. Obviously, it is the insured's interests that were at risk. If you can show that the insurance company was uncaring, you bolster your case for punitive damages.

More traditional questions for punitive damage purposes are:

1. What is the financial status of the company?[41]

2. How bad was its behavior?[42]

3. How long did the wrongful conduct persist?

4. Does the insurance company have an opportunity to repeat this conduct?

Finally, the Civil Practice Act in Illinois governs the pleading of punitive damages.[43] Proper pleading rules must be followed or the lawyer runs the risk of having the claim barred.

*B. Defenses*

The insurance company is not without ammunition in response to your bad-faith case. Their primary argument will be that 215 ILCS 5/155 (1996)[44] preempts the claim for damages. It seems clear from the dicta of *Cramer* that the supreme court believes 155 does not preempt third-party cases, but that is, after all, only dicta.

A second line of defense, also based on *Cramer*, is the concurrence of Justice Freeman. In it, the now-chief justice draws a distinction between third-party and first-party cases. Insurance company lawyers will argue that this logic should preempt compensatory and punitive damages.

A response to these defenses can be had in nearly any case which, before *Cramer*, ruled punitive damages were preempted by section 155. In virtually all of these cases, the courts hold that punitive damages might be possible but for the statute preempting them out of existence. Since *Cramer*'s resurrection of the tort, these courts would surely also hold that it is proper to obtain punitive damages in the right case as well.[45]

## VII. Conclusion

The tort of bad-faith refusal to settle has come a long way since its inception. After initial confusion, it has recently been clarified. Plaintiffs' attorneys who follow the right steps in the right case have every hope of recovering full compensation for their clients, along with punitive damages to prevent future conduct.

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31. *LaRotunda v Royal Globe Ins. Co.*, 87 Ill App 3d 446, 408 NE2d 928 (1st D 1980); *Kavanaugh v Interstate Fire & Cas. Co.*, 35 Ill App 3d 350, 342 NE2d 116 (1st D 1975).

32. *LaRotunda*, 87 Ill App 3d 446 (insurer can reject what appears a bad deal and proceed to trial; loss at trial does not guarantee a bad faith victory).

33. *Country Mut. Ins. Co. v Anderson*, 257 Ill App 3d 73, 628 NE2d 499 (1st D 1993).

34. In the non-tort context, see *Brody v Finch Univ. of Health Sciences/The Chicago Med. School*, 298 Ill App 3d 146, 156, 698 NE2d 257 (2d D 1998) (holding bad faith by medical school in raising the bar for prospective admittees and not informing them until after orientation).

35. The levels of this communication should be targeted to the insured. Simply sending a form letter that the insured does not understand is not enough. See *Steele v Hartford Fire Ins. Co.*, 788 F2d 441 (7th Cir 1986) (insured won't listen to advice, need not convince).

36. See *Bad Faith*, § 3.06-3.08.

37. *Mid-America Bank & Trust Co. v Commercial Union Ins. Co.*, 224 Ill App 3d 1083, 587 NE2d 81 (5th D 1992); *Cernocky v Indemnity Ins. Co.*, 69 Ill App 2d 196, 216 NE2d 198 (2d D 1966). That does not mean paramount, but merely equal to, its own. *Adduci v Vigilant Ins. Co., Inc.*, 98 Ill App 3d 472, 424 NE2d 645 (1st D 1981).

38. See *Cernocky v Indemnity Ins. Co. of North Amer.*, 69 Ill App 2d 196, 216 NE2d 198 (2d D 1966) (evidence considered included the testimony of the defense attorney).

39. *Prosser & Keeton on Torts* § 2 (5th ed 1984).

40. See Illinois Pattern Instructions (Civil) Nos. 10.00 (negligence); 700.01 (contract cases); 800.06-.07 (fraud); and 35.01 (willful and wanton conduct) for examples.

41. The financial status of the insurance company is always relevant for punitive damage purposes. See *Chicago Union Traction Co. v Lauth*, 216 Ill 176, 74 NE 738 (1905).

42. For really bad conduct, see *Emerson v American Bankers Ins. Co. of Florida*, 223 Ill App 3d 929, 585 NE2d 1315 (5th D 1992).

43. 735 ILCS §5/2-604.1 (1996).

44. That section states:

> Attorney fees. (1) In any action by or against a company wherein there is in issue the liability of a company on a policy or policies of insurance or the amount of the loss payable thereunder, or for an unreasonable delay in settling a claim, and it appears to the court that such action or delay is vexatious and unreasonable, the court may allow as part of the taxable costs in the action reasonable attorney fees, other costs, plus an amount not to exceed any one of the following amounts: (a) 25% of the amount which the court or jury finds such party is entitled to recover against the company, exclusive of all costs; (b) $25,000; (c) the excess of the amount which the court or jury finds such party is entitled to recover, exclusive of costs, over the amount, if any, which the company offered to pay in settlement of the claim prior to the action.

45. *Emerson v American Bankers Ins. Co. of Florida*, 223 Ill App 3d 929, 585 NE2d 1315 (5th D 1992) (holding no punitives because section 155 preempts them).