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## ILLINOIS LAW MANUAL

### CHAPTER XIII

### **BAD FAITH AND EXTRA CONTRACTUAL LIABILITY**

#### **A. EXCESS JUDGMENTS IN THIRD PARTY CLAIMS**

##### **1. Basic Law**

An insured or an assignee may recover extra-contractual damages from an insurer if the insurer fails or refuses to settle a claim within the liability policy limits, the judgment entered against the insured exceeds the liability policy limits, and the insurer's failure or refusal to settle the claim was in bad faith. *Cramer v. Insurance Exchange Agency*, 174 Ill.2d 513 (1996); *Haddick v. Valor Insurance Co.*, 198 Ill.2d 409 (2001). Similarly, a primary insurer that fails to settle an action within its policy limits may be liable to an excess insurer if a judgment in excess of the primary limits is ultimately entered. *Schal Bovis, Inc. v. Casualty Ins. Co.*, 314 Ill. App. 3d 562 (1st Dist. 1999).

##### **2. Analysis**

At the outset, it must be noted that a plaintiff has no direct cause of action against an insured tortfeasor's insurer. *Edwins v. General Casualty Co. of Wisconsin*, 78 Ill. App. 3d 965, 968 (1979); *Garcia v. Lovellette*, 265 Ill. App. 3d 724 (1994).

Nonetheless, an insured tortfeasor's cause of action against his or her insurer for bad faith in failing to settle within the liability policy limits can be assigned to the plaintiff judgment creditor. Brown v. State Farm Mut. Auto. Ins. Co., 1 Ill. App. 3d 47, 48-51 (1971). Such an assignment can be forced and a judgment debtor (insured) can be compelled, in a citation to discover assets proceeding, to assign a judgment creditor's bad-faith cause of action against his insurer. Phelan v. State Farm Mut. Auto. Ins. Co., 114 Ill. App. 3d 96 (1983); Nicholson v. St. Anne Lanes, Inc., 158 Ill. App. 3d 838 (1987). An assignee's rights are, however, no greater than the insured's rights. Edwins, 78 Ill. App. 3d at 968.

An insurer has a duty to act in good faith when responding to settlement offers. The duty to settle arises when a claim has been made against the insured and there is a reasonable probability of recovery in excess of policy limits, and a reasonable probability of a finding against the insured. The duty does not arise until a third party demands settlement within the policy limits. Haddick, 198 Ill.2d at 417.

If it appears that there is a probability of an adverse judgment at trial against the insured and that the judgment is likely to exceed the policy limits, an insurer must give equal consideration to both its own interests and its insured's interests in negotiating a settlement of the case. Stevenson v. State Farm Fire & Cas. Co., 257 Ill. App. 3d 179, 183 (1993). It is bad faith for an insurer to give greater consideration to its own interests in negotiating a settlement on behalf of its insured. Mid-America Bank & Trust v. Commercial Union Ins. Co., 224 Ill. App. 3d 1083, 1087 (1992); Browning v. Heritage Ins. Co., 33 Ill. App. 3d 943, 947 (1975).

Where it appears that the probability of an adverse finding on liability is great and the amount of damages would exceed the policy limits, the insurer has a duty to settle within the policy limits or face an excess liability claim for a breach of the duty owed to the insured.

Phelan v. State Farm Mut. Auto. Ins. Co., 114 Ill. App. 3d 96 (1983). It is not bad faith, however, to refuse to settle if liability coverage was fairly debatable. Stevenson v. State Farm Fire & Cas. Co., 257 Ill. App. 3d 179 (1993).

Likewise, an insurer's refusal to settle within the policy limits is in bad faith and will render the insurer liable to the insured or the assignee for the full amount of the judgment if the insurer is aware of:

- (1) an offer to settle at or within the policy limits;
- (2) the extent of the plaintiff's injury;
- (3) the possible personal liability of the insured tortfeasor;
- (4) the risk of excess liability if taken to judgment; and
- (5) a possible bad faith claim, but simply refuses to settle within the policy limits.

Mid-America Bank & Trust, 224 Ill. App. 3d at 1087. On the other hand, an insurer's act of securing a settlement for policy limits on behalf of one insured without obtaining a discharge of another insured is not, in and of itself, bad faith. Country Mut. Ins. Co. v. Anderson, 257 Ill. App. 3d 73, 79 (1993); See also Pekin Ins., 134 Ill. App. 3d at 34. This is so because "[i]t is an insurer's unreasonable failure to pursue a settlement offer, rather than its acceptance of one, which will expose it to liability for bad faith." Country Mut., 257 Ill. App. 3d at 79.

Likewise, an insurer's refusal to settle within the policy limits is not in bad faith if there exists a coverage issue which is "fairly debatable." Stevenson, 257 Ill. App. 3d at 186. Moreover, an insurer's refusal to settle within the policy limits is not in bad faith if there is an issue as to whether the insurer owes coverage to the insured, a subsequent conflict of interest arises between the insurer and insured, and the insurer provides its insured with a defense by reimbursing him or her for the cost of defense-counsel independently retained by the insured. Id. at 186.

An excess insurer also has a direct cause of action against a primary insurer for failure to act reasonably in settling a claim within the primary policy limits. Schal Bovis, Inc. v. Casualty Ins. Co., 314 Ill. App. 3d 562 (1999). The excess insurer may recover that portion of a judgment in excess of the primary policy limits which the excess insurer was obligated to pay because of the primary insurer's unreasonable refusal to settle within the primary policy limits when an opportunity to settle existed.

In the case of first impression, The U.S. District Court for the Northern District of Illinois and Liberty Mutual Ins. Co. v. American Home Assurance Co., 348 F.Supp. 2<sup>nd</sup> 940 (2004) held that a first level excess insurance company owed no duty of good faith dealings to a higher level excess company. The reasoning for this is that neither insurance company had the duty that a primary insurance company had to defend and act in good faith to the named insured. They did not control the litigation nor participate in discovery.

If allowed an excess insurer may recover that portion of a judgment in excess of the primary policy limits which the excess insurer was obligated to pay because of the primary insurer's unreasonable refusal to settle within the primary policy limits when an opportunity to settle existed. In summary, an insurer has a duty to accept a reasonable offer to settle a claim against an insured if the offer is within the liability policy limits and there is a substantial likelihood of a judgment in excess of the liability policy limits. If the insurer fails or refuses to settle a claim within the policy limits and judgment is entered in excess of the liability policy limits, the insurer may be liable to the insured or the insured's assignee for the entire amount of the judgment.

## **Acts Constituting Improper Claims Practice:**

215 ILCS 5/154.6 list the Acts that constitute improper claims practice. They are as follows:

- (a) Knowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to coverages at issue;
- (b) Failing to acknowledge with reasonable promptness pertinent, communications with respect to claims arising under its policies;
- (c) Failing to adopt and implement reasonable standards for the prompt investigations and settlement of claims arising under its policies;
- (d) Not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear;
- (e) Compelling policyholders to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them;
- (f) Engaging in activity which results in a disproportionate number of meritorious complaints against the insurer received by the Insurance Department;
- (g) Engaging in activity which results in a disproportionate number of lawsuits to be filed against the insurer or its insureds by claimants;
- (h) Refusing to pay claims without conducting a reasonable investigation based on all available information;
- (i) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
- (j) Attempting to settle a claim for less than the amount to which a reasonable person would believe the claimant was entitled, by reference to written or printed advertising material accompanying or made part of an application or establishing unreasonable caps or limits on paint or materials when estimating vehicle repairs;
- (k) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured;
- (l) Making a claims payment to a policyholder or beneficiary omitting the coverage under which each payment is being made;
- (m) Delaying in investigation or payment of claims by requiring an insured, a claimant, or the physicians of either to submit a preliminary claim report and then

requiring subsequent submission of formal proof of loss forms, resulting in the duplication of verification;

- (n) Failing in the case of the denial of a claim or the offer of a compromise settlement to promptly provide a reasonable and accurate explanation of the basis in the insurance policy or applicable law for such denial or compromise settlement;
- (o) Failing to provide forms necessary to present claims within 15 working days of a request with such explanations as are necessary to use them effectively;
- (p) Failing to adopt and implement reasonable standards to verify that a repairer designated by the insurance company to provide an estimate, perform repairs, or engage in any other service in connection with an insured loss on a vehicle is duly licensed under Section 5-301 of the Illinois Vehicle Code;
- (q) Failing to provide as a persistent tendency a notification on any written estimate prepared by an insurance company in connection with an insured loss that Illinois law requires that vehicle repairers must be licensed in accordance with Section 5-301 of the Illinois Vehicle Code;
- (r) Engaging in any other acts which are in substance equivalent to any of the foregoing.

Changes may be proven by “such frequency to indicate a persistent tendency to engage in that type of conduct.” 215 ILCS 5/154.5.