PUSHING THE LIMITS

Six Steps for Responding to Pro-Forma Time-Limit Demands

By Mark E. Inbody and Savannah R. Montanez

The use of a policy-limits demand—coupled with a short time limit for acceptance—is a classic tool used to pressure insurers to settle cases of questionable damages. The time-limit demand is a win-win for claimants' counsel: If the insurer accepts the demand, then the claimant will recover the maximum amount available under the policy. If the insurer rejects the demand, then the claimant can potentially recover the full amount of his claim regardless of the policy limits—commonly known as "opening" or "taking the lid off" the policy.

Where the evidence is well developed, courts have upheld rather short time limits on such demands. (See *Critz v. Farmers Ins. Group*, 230

Cal.App.2d 788 [1965]). But courts have also recognized for decades that time-limit demands can be used as a bad-faith setup. (See *White v. Western Title Ins. Co.*, 40 Cal.3d 870 [1985]).

As counsel representing insurers, we see an increasingly common practice of claimants' counsel sending cut-and-pasted time-limit demands at the outset of a claim. Clearly, these letters are intended to pressure the insurer to accept the demand and avoid the risk of opening the policy. But "pay" or "deny" are not the insurer's only two options. In fact, the insurer has a number of responses that not only negate the effectiveness of a pro-forma demand, but also demonstrate the insurer's reasonable, good-faith claims handling.

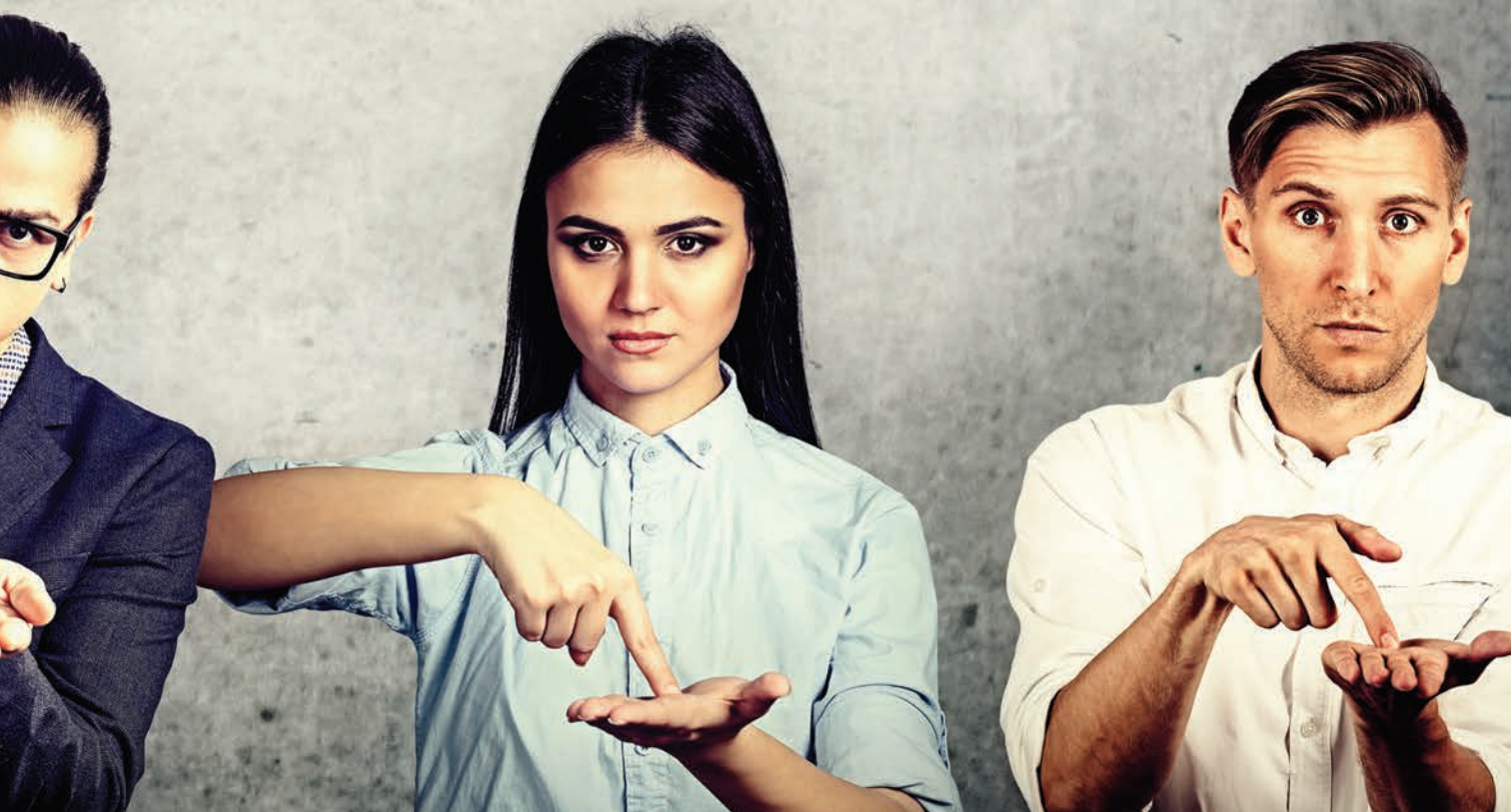
An insurer's duty to settle in good faith is triggered when it receives a policy-limits demand. According to the American Law Institute, this duty of good faith requires the insurer to give at least equal consideration to the insured's interests as its own in deciding whether to accept the demand. The most common test for determining whether the insurer satisfied this requirement is to ask whether a reasonable insurer without policy limits would have accepted the demand.

Thus, the insurer does not have a duty to settle, but rather a duty to make reasonable settlement decisions. In most jurisdictions, the insurer's failure to make reasonable settlement decisions will open the policy limit. But the insurer can protect itself from excess liability by responding to policy-limits demands in a way that clearly demonstrates its reasonableness. Following are six steps by which an insurer can evaluate an early time-limit demand.

STEP ONE: IS THERE A BASIS FOR A TIME LIMIT?

When a claimant's counsel serves a time-limit demand upon an insurer early in a claim, the insurer likely has insufficient information regarding the claimant's damages and the insured's potential liability. The time limitation itself tightens the window for the insurer to gather the necessary information before the limit expires.

Some courts hold that claimants are entitled to set time limits, but insurers are not necessarily bound by them. An insurer in this circumstance should request an extension of time to properly investigate and evaluate the claim. Courts tend to find such requests to be reasonable, provided the insurer explains in detail why additional time is needed. Conversely, a refusal to grant additional time by claimant's counsel will likely be viewed as unreasonable.



In its request for an extension of time, the insurer should specify what additional facts, documents, statements, authorities, or photographs it needs to assess the claimant's damages and the insured's likelihood of liability (for example, early policy-limits demands frequently do not contain police reports or complete medical records). The insurer should communicate its efforts in writing to obtain necessary information to respond to the demand, particularly challenges presented by the claimant. Additionally, insurers must document their efforts to obtain information from the claimant as well as the insured and other sources.

STEP TWO: DOES THE CLAIMANT KNOW THE POLICY LIMIT?

A pro-forma time-limit demand, particularly one that is sent as a matter of course at the outset of a claim, may not identify the insurer's limits. State requirements vary widely—some require an insurer to provide limits to claimants (Georgia and Florida); some prohibit it without the insured's consent (California).

There is little-to-no case authority addressing the effectiveness of a policy-limits demand where the limits are unknown to the claimant, but it is likely that a court would deem an uninformed "shot in the dark" to be ineffective. In any event, an insurer should ask both claimant's counsel and its own insured whether that information has been divulged.

STEP THREE: IS THERE A CLEAR, COMPLETE RELEASE?

Upon receiving a policy-limits demand, the insurer should analyze it for potentially unclear terms or contingencies. If the demand contains any unclear terms, then the insurer should ask the claimant for clarification. In fact, if the insurer rejects a policy-limits demand without asking the claimant to clarify unclear terms, then the insurer likely will neither be able to avoid bad-faith liability down the road by arguing the demand was uncertain, nor will it be able to simply ignore the demand.

As a common example of unclear contingencies, a policy-limits demand may be "subject to" the existence of other insurance benefits. An insurer cannot accept such a demand, as it does not release its insured from liability. To the contrary, an insurer risks bad faith by funding further litigation against any other assets. An insurer should only accept a demand that results in a complete release of its insured.

THE INSURER DOES NOT HAVE A DUTY TO SETTLE, BUT RATHER A DUTY TO MAKE REASONABLE SETTLEMENT DECISIONS.

Another key contingency of any settlement is the release of any liens, particularly Medicare or similar state liens. Acceptance of a demand without such a release potentially exposes the insurer to having to essentially pay medical bills twice. California courts have held that release of medical liens is a necessary term for proper settlement, so if the demand does not include that release, then an insurer can reject the demand on that basis.

If the policy-limits demand is missing either of the components mentioned in this step, then the insurer should point out that it is unable to accept a legally insufficient demand that results in a complete release of its insured.

STEP FOUR: ARE ALL INSUREDS RELEASED?

Although an insurer has a duty to make reasonable settlement decisions, it also has a duty to protect its insureds from personal liability. This requires the insurer to identify when a policy-limits demand omits or misidentifies an insured. Most jurisdictions allow an insurer to exhaust the policy limits in favor of one insured, provided the insurer informs the omitted or misidentified insured of the matter.

In other jurisdictions, however, the insurer cannot exhaust the policy limits in favor of one insured. In those jurisdictions, the insurer should advise the claimant that it cannot reasonably

accept a policy-limits demand that does not fully and finally release all insureds. The insurer can also ask the claimant to reform the demand to include all insureds and/or remove any settlement contingencies imposed upon the insureds.

STEP FIVE: ARE ALL CLAIMANTS RELEASED?

Consistent with the insurer's good-faith duty to protect its insureds from personal liability, an insurer cannot exhaust the policy limits in favor of one claimant to the exclusion of others. Accordingly, an effective policy-limits demand must include all third-party claimants in most jurisdictions. This can be a more slippery problem than identifying all insureds, but if it is a potential issue, then the insurer should advise the claimant that his demand is unreasonable because there are (or are likely to be) multiple claims. While the multiple-claimant problem can become quite complex, the insurer can consider the appropriateness of offering the claimant a payment less than the policy limits, suggest a global mediation, or potentially interplead the limits.

STEP SIX: WILL DAMAGES EXCEED THE LIMITS?

To reiterate, an insurer does not have a duty to settle, but rather a duty to make reasonable settlement decisions. If the answer to one or more of the previous questions is "no," then the insurer likely has valid grounds to reject the policy-limits demand as legally inadequate. Even if the answers to the stated questions are all "yes," an insurer still may reject a policy-limits demand outright if the facts known or available to the insurer at the time of the demand show that the claimant's damages are within policy limits and/or that the insured is not liable.

While rejection of a policy-limits demand is ultimately a question of fact evaluated under the totality of the circumstances, some common factors that courts consider include the strength of the claimant's case, the adequacy of the insurer's investigation, the insurer's failure to follow the advice of its attorneys or adjusters, the insurer's willingness to engage in settlement negotiations, the quality of communication between the insurer and the insured, and the insured's inexcusable failure to respond to a time limit placed on the demand. (See *Rova Farms Resorts Inc. v. Investors Ins. Co. of Am.*, 65 N.J. 474 [1974]). Some jurisdictions (Illinois and New York) also allow the insurer to consider coverage defenses in rejecting a policy-limits demand; others, like California, do not. For some, like Florida, it depends.

In rejecting a policy-limits demand, the insurer should explain its reasoning in as much detail as possible. The insurer should recount its investigation efforts and identify the specific information it relied upon in assessing the claimant's damages and the insured's liability. Additionally, an insurer may wish to consider retaining defense counsel to evaluate the liability exposure of the insured so that it has the protection of a professional third-party evaluation. (See *Westchester Fire Ins. Co. v. Mid-Continent Cas. Co.*, 954 F.Supp.2d 1374 [S.D. Fla. 2013]). It is essential for insurers to keep detailed claims files and notes, and the insurer should also communicate its reasoning to both the claimant and the insured.

The pro-forma time-limit demand is a low-cost way for claimants' counsel to pressure an insurer to settle, and it creates pitfalls for inattentive insurers. But an insurer does not have to accept a policy-limits demand or risk opening the policy limit. The investigative strategies outlined demonstrate an insurer's good-faith investigation and evaluation. While an insurer cannot prevent claimants' counsel from arguing that policy limits are open, providing a timely response with one or more of the defects in the demand should keep the insurer's ultimate indemnity obligation within limits. ■

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