

In this Issue...

Court Rules That Insured Can Settle a Suit, Over the Insurer's Objection, If the Insurer Wrongly Refuses to Settle	1
Choice of Law Rules	3
Contact Information	5

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IN A CASE OF FIRST IMPRESSION, ILLINOIS APPELLATE COURT RULES THAT INSURED CAN SETTLE A SUIT, OVER THE INSURER'S OBJECTION, IF THE INSURER WRONGFULLY REFUSES TO SETTLE

In SwedishAmerican Hosp. Assoc. of Rockford, et al. v. Illinois State Medical Inter-Ins. Exchange, 2009 WL 3048427 (Ill.App. 2 Dist., September 18, 2009), the Appellate Court of Illinois, Second District, addressed the issue of whether an insured violates a policy's "no action clause" (that prohibits an insured from settling a suit without the insurer's consent) when the insured settles a suit over the insurer's objection and before judgment.

In *SwedishAmerican*, the underlying claim arose out of a malpractice suit filed against a doctor and hospital alleging that their negligence caused spastic quadriplegia in the plaintiff infant. Illinois State Medical Inter-Insurance Exchange ("ISMIE") insured the doctor under a medical malpractice insurance policy providing \$1 million in coverage. The hospital self-insured \$1.5 million for itself and its employees, including the doctor. The Hospital also had a \$25

million excess policy above its \$1.5 million in self insurance.

ISMIE defended the suit against the doctor without a reservation of rights. Prior to trial, a dispute arose between the doctor, the hospital, the hospital's excess insurer and ISMIE over whether the case should be settled. The plaintiff demanded \$9 million to settle with the hospital and doctor. The doctor advised ISMIE that he wanted the case settled.

The hospital, the excess insurer and the doctor demanded that ISMIE contribute its \$1 million to a proposed settlement. Although ISMIE believed that a potential verdict against the doctor would likely be in the millions of dollars, ISMIE refused, contending that the case was defensible. The ISMIE policy, however, required that all disputes over whether a case should be settled be submitted to a physician review committee. ISMIE submitted the dispute to the physician review committee, who

agreed with ISMIE that the case should be tried.

Ultimately, the hospital, the hospital's excess insurer and the doctor settled the underlying lawsuit for \$5 million and demanded that ISMIE contribute its \$1 million policy limits. ISMIE refused, and the doctor assigned his rights to recover the \$1 million ISMIE policy limits to the Hospital and the excess carrier. Thereafter, the Hospital and the excess carrier filed a declaratory judgment action against ISMIE to recover the \$1 million that it refused to contribute toward the settlement.

In the trial court, the Hospital and its excess insurer argued that ISMIE breached the duty of good faith when it refused to contribute to the settlement of the claims against the doctor and, therefore, ISMIE could not rely on the "no action clause" to deny coverage for the settlement. ISMIE took the position that because it had fully-defended the doctor and had never denied coverage, the ISMIE policy's "no action clause" prohibited the doctor from settling without ISMIE's consent. The trial court agreed with ISMIE and granted it summary judgment. The Hospital and the excess insurer appealed the trial court's ruling. The Appellate Court reversed and remanded the case for the trier of fact to resolve certain material issues of fact.

The Appellate Court of Illinois first addressed the hospital's and excess carrier's argument that an insurer cannot rely upon a "no action clause" to deny coverage for an insured's pretrial settlement when the insurer, although fully-defending the insured, breaches its duty of good faith by arbitrarily refusing to settle within policy limits. The Appellate Court held:

Here, it would be unfair to enforce the no-action provision against Dr. Hecht for securing a reasonable settlement if ISMIE breached its good faith duty to settle and exposed Dr. Hecht to liability exceeding the policy limits, despite the case not having been tried and despite ISMIE's initial fulfillment of its duty to defend. Breach of the good faith duty to settle is considered by other jurisdictions, and we agree, to be an extension of the duty to defend.

Next, the Appellate Court addressed ISMIE's argument that the claims against it must fail because the insured suffered no damages. ISMIE argued that there were no damages because there was no excess judgment entered against the insured and the doctor was not personally liable for the settlement because the hospital and the excess carrier paid the settlement. The Appellate Court ruled that the plaintiffs did not need to establish that the insured was personally liable for a judgment or the settlement amount stating: "we reject ISMIE's claim that, because Dr. Hecht suffered no personal damages in excess of the ISMIE policy limit, he would be unable to recover the policy limit if ISMIE breached its good-faith duty." Rather, if ISMIE breached the duty to settle, plaintiffs need only establish that the doctor "settled in reasonable anticipation of liability."

The Appellate Court held that whether ISMIE breached its good-faith duty to settle and whether the doctor settled in reasonable anticipation of liability presented questions of fact that, on the record before it, could not be resolved on summary judgment. The court also held that the insured bears the burden of demonstrating that he settled in reasonable anticipation of liability.

Finally, the Appellate Court rejected

ISMIE's argument that, because the physician review committee recommended that the case be tried, ISMIE could not be in breach of the duty to settle. The Appellate Court noted that, although the policy contained a provision requiring disputes over whether to settle the case be submitted to a physician review committee, there was conflicting evidence as to whether ISMIE's claims adjusters actually felt the case should be tried. Surprisingly, however, the Appellate Court stated that, "even if this provision [the physician review committee] had been properly triggered, this provision does not relieve ISMIE of its good-faith duty to settle, as the good-faith duty is to be determined in a court of law, not by a panel of physicians."

COMMENT: There are a number of fundamental problems with the *SwedishAmerican* decision. For example, the Appellate Court cites to the Illinois Supreme Court's decision in *Krustsinger v. Illinois Cas. Co.*, 10 Ill. 2d 518, 527 (1957), to support the proposition that an insured can settle a case prior to trial without the insurer's consent if the insurer wrongfully refuses to settle. The *Krustsinger* decision, however, does not stand for that proposition. In *Krustsinger*, the insurer breached its duty to defend and then the insured settled. No prior Illinois case has allowed an insured

Continued on page 4



DECISION WORTH NOTING...

On August 31, 2009, the New Jersey District ruled that Foremost Insurance Company ("Foremost") did not act in "bad faith" for withholding benefits under a homeowner's policy since Foremost's interpretation of its own ambiguous "other insurance" insurance clause was not unreasonable. In *Rothschild v. Foremost Ins., Co.*, 2009 WL 2778344 (D.N.J., August 31, 2009), Plaintiffs Zeev and Bracha Rothschild ("Plaintiffs") suffered a total fire loss to their home, which was insured by Foremost and another insurer. Foremost's policy contained an "other insurance" clause, which provided that "[i]f both this and other insurance apply to a loss, [Foremost] will pay [its] share. [Its] share will be the proportionate amount that this insurance bears to the total amount of all applicable insurance." Based on this clause and the availability of other insurance, Foremost agreed to pay 55% of its policy limit toward the loss (which was calculated by dividing Foremost's policy limit into the total amount of available insurance). Plaintiffs disagreed and sued Foremost for the entire policy limit, or, in the alternative, 55% of the total loss. Plaintiffs also sued Foremost for "bad faith" for withholding a portion of the policy benefits. The District Court interpreted the "other insurance" clause in Foremost's policy as requiring Foremost to pay 55% of the total loss, not 55% of the limits of its policy. However, the District Court held that Foremost did not act in "bad faith" under New Jersey law since Foremost's "other insurance" provision was ambiguous and Foremost's interpretation of its own "other insurance" clause was not unreasonable. The District Court also held that the "dearth of case law" suggests there is no clearly delineated principle that Foremost recklessly disregarded in "bad faith."

TENTH CIRCUIT, APPLYING KANSAS CHOICE-OF-LAW RULES, HOLDS THAT A JUDGMENT CREDITOR'S CAUSE OF ACTION FOR "BAD FAITH" REFUSAL TO SETTLE WAS GOVERNED BY KANSAS LAW -- WHERE THE DEMAND WAS MADE AND REJECTED -- RATHER THAN MISSOURI LAW -- WHERE THE UNDERLYING TORT ACTION WAS FILED

In *Moses v. Halstead*, No. 08-3088, 2009 U.S. App. LEXIS 20023 (10th Cir., September 8, 2009), the Tenth Circuit found that, under Kansas choice-of-law rules, a creditor's cause of action for negligent or "bad faith" refusal to settle against the insurer was governed by the law of Kansas, the place where the contract was made, rather than the law of Missouri, the place where the underlying tort action was filed against the debtor.

On November 22, 1996, Shelby Moses was injured in a car accident in Missouri while riding as a passenger. The car was given to Ms. Moses by her father and driven by Chris Halstead. Allstate Insurance Company ("Allstate") insured the vehicle for uninsured motorist coverage and had issued the policy in Kansas to Ms. Moses' father, a Kansas resident. Mr. Moses subsequently filed a claim with Allstate for his daughter's injuries. One year later, Ms. Moses' counsel made an offer to settle her claims with Allstate for the policy limit of \$25,000. Allstate rejected the offer. Both Ms. Moses' offer to settle and Allstate's rejection of it occurred in Kansas.

Ms. Moses then filed a tort action against Mr. Halstead in Missouri where the jury awarded Ms. Moses \$100,000 in actual damages. Allstate paid Ms. Moses \$25,000 in partial satisfaction of the judgment. Ms. Moses registered the judgment in Kansas state court and requested an Order of Garnishment against Allstate for its alleged negligent or "bad faith" refusal to settle with her on her claim against Mr. Halstead. Allstate removed the case to federal court and subsequently filed a motion for summary judgment, which the district court denied. Both parties based their summary judgment arguments on Kansas law.

During trial, Allstate changed its position and contended instead that Missouri law should be applied. Following a bench trial, the district court held that Missouri law governed Ms. Moses' claim and that, under Missouri law, Allstate had acted in "bad faith" in refusing to settle. Allstate filed a motion for reconsideration, arguing that Ms. Moses did not have an assignment of Mr. Halstead's rights, which is required under Missouri law before a judgment creditor can file an

action against an insurance company for its "bad faith" refusal to settle. Kansas law does not require such an assignment. The district court applied Missouri law and granted Allstate's motion for reconsideration.

The Tenth Circuit reversed, holding that Kansas law governed both: (1) the existence of Allstate's contractual obligation to act in good faith to settle; and (2) whether Allstate fulfilled its contractual obligation to act in good faith to settle. In its analysis, the Tenth Court noted that, when addressing choice of law issues, Kansas courts follow the Restatement (First) of Conflict of Laws (1934). When the question raised by the contractual dispute goes to the substance of the obligation, Kansas courts apply the rule of *lex loci contractus*, which calls for the application of the law of the state where the contract is made. However, when the question goes to the manner and method of performance of the contract, the law of the place of performance applies. Allstate argued that, since claims for a wrongful failure to settle arise from the insurer's contractual obligation to defend and the Missouri tort action was where the duty to defend arose, Missouri law should apply. Ms. Moses, on the other hand, contended the law of the place of contracting should apply.

The Tenth Circuit held that, under the Kansas choice-of-law rules, whether Ms. Moses had a cause of action for negligent or "bad faith" refusal to settle against Allstate goes to the substance of Allstate's contractual duties rather than the manner of performance under the insurance policy. Therefore, the issue was governed by the law of the place where the contract was made, in this case Kansas.

As for whether Allstate fulfilled its contractual obligation to act in good faith to settle Ms. Moses' claim, the Tenth Circuit noted, in general, fulfillment of a contractual obligation goes to the manner and method of performance by the party charged with the obligation, not to the substance of the obligation. Since both Ms. Moses' offer to settle and Allstate's rejection of the offer took place in Kansas, the district court should have applied Kansas law to determine whether Allstate fulfilled its contractual obligation to consider Ms. Moses' settlement offer in good faith.

Applying Kansas law, the Tenth Court then decided that Ms. Moses, as a judgment creditor, had a right to proceed by garnishment against Allstate. Under Kansas law, once judgment has entered, the judgment creditor takes the place of the judgment debtor and may take that which the latter could enforce. Accordingly, Ms. Moses did not need to obtain an assignment of rights from Mr. Halstead before she acquired the right, as his judgment creditor, to bring a claim against Allstate in excess of the policy limit for a negligent or "bad faith" refusal to settle.



Prepared by David Clark, an associate in our Orange County office.

to settle a case without the insurer's consent unless the insurer previously breached the duty to defend and/or an excess judgment had already been entered against the insured.

Second, allowing the insured to unilaterally settle prior to judgment and without the insurer's consent effectively takes away the insurance company's right to control settlement. It could also: 1) result in the underlying plaintiffs pitting the insured against its insurance company during settlement negotiations; 2) interfere with the insurance company's right to control the timing of settlement; and 3) deny the insurance company the right to take a case to trial and obtain a defense verdict in close cases. Moreover, the insured already has a remedy when an insurer breaches its duty to settle and an excess verdict is entered against the insured; the insured can sue the insurer and recover damages.

Finally, the case is troubling because it disregarded a specific contractual provision contained in the policy to

resolve disputes over whether a suit should be settled. Despite the fact that the insurer and insured had agreed in the insurance contract that a physician review committee was to resolve any dispute over whether to settle, the *SwedishAmerican* court effectively ruled that the court would be the ultimate arbiter of whether a case should, in good faith, be settled. This is a substantial interference with the parties' freedom of contract.



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DECISION WORTH NOTING...

The Northern District of Georgia recently declined to establish a bright line rule that a plaintiff's attorney can "set up" an insurer for an excess judgment by merely offering to settle within policy limits and by imposing an unreasonably short time within which the offer would remain open. In *Butler v. First Acceptance Ins. Co., Inc.*, 2009 WL 2581288 (N.D.Ga., August 17, 2009), a motor vehicle accident victim ("Plaintiff") made a time-limited settlement demand to the driver's insurer, First Acceptance Insurance Company ("First Acceptance"), to settle within policy limits prior to instigating a personal injury lawsuit. Due to an intervening holiday, First Acceptance had less than five full business days to respond. Although First Acceptance timely responded to the demand, it tendered its policy limits "contingent upon protection of any and all hospital liens, and a waiver of subrogation from [Plaintiff's] employer's workers' compensation carrier. . . ." Plaintiff deemed this conditional acceptance as a rejection and sued First Acceptance's insured. Several weeks later, First Acceptance offered its limits unconditionally, stating that it completed its check of liens that its insured could potentially be obligated to satisfy. Plaintiff rejected this offer, obtained a consent judgment against First Acceptance's insured for \$3.25 million and an assignment of the insured's rights against First Acceptance. Plaintiff then sued First Acceptance for the entire judgment based on First Acceptance's tortious failure to settle Plaintiff's first demand within policy limits. Before the District Court were Plaintiff's and First Acceptance's cross-motions for summary judgment.

The District Court rejected First Acceptance's argument that it was insulated from an excess judgment since it did initially tender its policy limits. The District Court held that the conditional tender of limits was a counter-offer and rejection of Plaintiff's demand. The District Court also rejected First Acceptance's argument that it could not be held liable for the excess judgments based on its subsequent unconditional tender of policy limits. However, the District Court concluded that, while Georgia law, apparently, recognizes the possibility for a plaintiff's attorney to "set up" an insurer for an excess judgment, a "bad faith" failure to settle does not exist merely because an insurer rejects a time-limited settlement demand. The District Court held that a disputed issue of fact existed "as to whether, under the totality of circumstances. . . Plaintiff can show that [First Acceptance] did not act as an ordinarily prudent insurer or put its own interest above those of the insured. . . ." Accordingly, the District Court denied the parties' cross-motions for summary judgment and said that a jury will hear all of the circumstances of the interaction between Plaintiff's counsel and First Acceptance to determine whether First State's actions were in "bad faith".



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