

Serving Two Masters: Duties Owed To The Insured And The Insurer In Potential Policy Limits Cases And In Coverage Disputes

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INTRODUCTION

In defending automobile liability cases, the insurer and the attorney hired to defend the insured are often faced with questions that go beyond the litigation itself. When the plaintiff makes a demand within the limits of the defendant's liability insurance policy, for example, the insurer must decide whether to settle or proceed to trial and risk an excess verdict that may lead to a claim of bad faith. This situation arises frequently in the context of automobile liability insurance because damages often exceed the minimum coverage required by law.¹ Defense counsel must serve two masters. The attorney obviously owes a duty to the insured to protect the insured's interests, but the attorney must also be aware of the interests of the company who hired him to defend the insured. The policy limits case can present a very real dilemma to both the insured and the insurer, and the attorney may feel the pull of conflict in advising both. The attorney may also perceive a conflict whenever coverage disputes arise. Whether the conflicts are real or only apparent, both the insurer and defense counsel must be cognizant of the duties which spring from the attorney-client relationship and the contractual terms of the policy itself. The purpose of this paper is to revisit the law - and the supporting public policy - governing the duties owed in liability limits demand cases and the potential consequences for the insurer's refusal to settle. The paper will also discuss the insurer's duty to defend

¹ In 2001, the minimum liability limits increased to \$25,000 per person, \$50,000 aggregate, and \$25,000 for property damage. O.C.G.A. § 40-9-37 (a).

and the proper methods for resolving coverage disputes and avoiding penalties for bad faith.

DUTIES AND CONSEQUENCES IN POLICY LIMITS DEMAND CASES

Automobile litigation is driven by economic realities. Minimum liability limits frequently fail to compensate the plaintiff for the full amount of damages and, given the judgment-proof status of many defendants, plaintiffs often must content themselves with settling for the policy limits. Problems arise when the insurer refuses to accept an offer of settlement within policy limits, and the plaintiff proceeds to trial and obtains an excess verdict. Insurers are then faced with a potential lawsuit from their insured for bad faith refusal to settle within the policy limits.

The Equal Consideration Rule

Any discussion of the issues involved in policy limits cases must begin with *State Farm Mutual Auto. Ins. Co. v. Smoot*, 381 F.2d 331 (1967) and *United States Fidelity & Guar. Co. v. Evans*, 116 Ga. App. 93, 156 S.E.2d 809 (1967), *aff'd*, 223 Ga. 789, 158 S.E.2d 243 (1967). Both cases examine in-depth the duties owed by the insurer when presented with a demand for settlement within policy limits, and both cases remain good law today.

In *Smoot*, State Farm fought a long and ultimately unsuccessful fight which arose out of an automobile accident on November 5, 1955. State Farm insured Smoot under an automobile liability policy with minimum limits of \$10,000 per person. Smoot rear-ended the plaintiff causing a severe whiplash injury and misalignment of a cervical

vertebra. The plaintiff's attorney initially offered to settle the claim for \$2,500 and, sometime later, \$4,000. State Farm rejected both offers. As the plaintiff's condition deteriorated, her attorney offered to settle the case for \$5,000. State Farm rejected this offer. The old Fifth Circuit Court of Appeals noted that it was of "great significance" that Smoot was never informed of the offers or the rejections. The plaintiff finally filed suit in which she asked for \$33,980 for herself and \$2,922 for her husband. State Farm then wrote Smoot a letter advising him of the demand in excess of the liability policy and of his potential personal liability. The letter also advised Smoot he could secure his own attorney at his own expense to protect his personal interests.

Just before trial, State Farm offered \$5,000 for the settlement of both cases, but this offer was refused. The plaintiff was again examined by physicians before trial, but, as the Court noted, State Farm did not seek to ascertain the results. The Court emphasized that, at trial, two physicians testifying for the *defense* essentially confirmed the plaintiff's injuries and testified the injuries were permanent. The Court further noted State Farm was aware the doctors would so testify. The jury returned a verdict for \$26,902.

Smoot sued State Farm for the amount of the judgment in excess of his policy limits. When the case was finally tried in the District Court, the jury found that State Farm was negligent, that Smoot was damaged as a result, that State Farm was guilty of bad faith, that such bad faith resulted in damages, and that Smoot was entitled to special damages in the amount of \$23,858, general damages in the amount of \$10,000, punitive damages in the amount of \$10,000, and attorney's fees in the amount of \$21,929. The

total amount of the verdict, for refusal to settle a case within the policy limits of \$10,000, was \$63,787.

The Fifth Circuit Court of Appeals affirmed. The Court discussed at length the obligations of the insurer:

The question under the good faith doctrine is whether in the light of [the facts of the case] the Insurer acted in good faith in failing to settle within the policy limits. By its very nature, that question encompasses the more specific ones concerning the reasonable valuation of the case, whether, at each stage, proposed settlements were rejected consciously in terms of deliberative judgment evaluation or because of other or no reasons. The conduct under inquiry is no longer the simple one of the driver of the assured vehicle. It is now the action of the Insurer in the light of the conduct of its driver-assured, the probable medical evidence, and the like.

381 F.2d at 334. Advising the insured of his right to secure his own personal attorney did not relieve the insurer of its “absolute obligation to exercise good faith.” *Id.*

The Insurer has one primary interest: to give that defense which the policy promised and to perform that promise in accordance with the standards of the local law (prudence or good faith). If its interests are antagonistic to the Assured, it has not fulfilled this promise. Its contract, with specified dollar limits, may perhaps put it in a somewhat difficult position. But always it must act with requisite care (good faith or prudence as the local law spells out) toward the Assured’s reinterest. It may, of course, properly consider its own interest, but it may never, never, forget that of its Assured.

Id. at 335.

The Court also addressed an issue which is very often a part of the relationship between defense counsel and the insurer which hires him:

There is a charge, nowhere answered or controverted in the annexed papers, that despite the array of distinguished, conscientious counsel supplied by the Insurer in the nominal defense of the damage suit, the whole thing was being directed by adjusters or other functionaries having insufficient judgment or ability either to direct or to choose a prudent course of action or determine in intelligent good faith just what the case

was worth in terms of the probabilities of success or failure in the event of trial.

Id. Thus, the Court held the insurer accountable for not utilizing its own counsel and allowing less than competent adjusters to direct the course of litigation, evaluation, and settlement negotiations.

That same year the Georgia Court of Appeals decided *United States Fidelity & Guar. Co. v. Evans*, *supra*. In this case, the insured defendant had liability coverage in the amount of \$10,000. The insurer refused to settle the case for \$9,500 prior to trial and then refused to accept a second settlement offer of \$10,000 following the jury's verdict for \$25,000. The insured sued the insurer, and a jury returned a verdict against it in the amount of the excess \$15,000, plus interest. The Court of Appeals affirmed this judgment.

The Court first noted that the insured is not required to pay the judgment before bringing an action against the insurer. The Court then went on to decide whether the evidence authorized a finding that the insurer breached its duty to its insured by failing to settle the case within the policy limits. The Court set out the standard which remains the standard today:

With respect to the decision whether to settle or try the case, the insurer, acting through its representatives, must use such care as would have been used by an ordinarily prudent insurer with no policy limit applicable to the claim. The insurer is negligent in failing to settle if, but only if, such ordinarily prudent insurer would consider that choosing to try the case (rather than to settle on the terms by which the claim could be settled) would be taking an unreasonable risk - that is, trial would involve chances of unfavorable results out of reasonable proportion to the chances of favorable results.

116 Ga. App. at 94-95 (citation and punctuation omitted).

In considering whether the insurer exercised good faith in its decision to appeal the underlying excess verdict, the Court held it was not necessary for the insured to show the appeal was frivolous. The Court stated the insurer must go beyond a consideration of its own self-interests. The insurer is answerable for a refusal to settle if the refusal was “arbitrary or capricious.” *Id.* at 95 (citation and punctuation omitted). The Court went on to state an insurer has an even greater duty to its insured when an offer is made for settlement within the policy limits after a verdict has been rendered in excess of the limits. In its simplest terms, the insurer’s duty to the insured is to “refrain from taking an unreasonable risk on behalf of its insured, e.g., where the chances of unfavorable results on appeal are out of proportion to the chances of favorable results.” *Id.* at 97. While recognizing it had an interest in appealing the case, the insurer was also bound to “give at least equal consideration to the interest of the insured.” *Id.* The Court concluded there was sufficient evidence to support the jury’s determination that the insurer failed to give its insured equal consideration.²

In *National Emblem Ins. Co. v. Pritchard*, 140 Ga. App. 350, 231 S.E.2d 126 (1976), the Court of Appeals confirmed the equal consideration rule and clarified apparently conflicting language in *Evans*. In *Pritchard*, the Court held invalid a jury charge which stated “the insurance company must consider as paramount [the insured’s] interests rather than its own.” 140 Ga. App. at 350. The Court held the insurer is required to give its insured equal consideration, not paramount consideration, and that

² See also *Thomas v. Atlanta Cas. Co.*, 253 Ga. App. 199, 205, 558 S.E. 2d 432 (2001) (insurer has a duty to its insured to “act with the utmost good faith” in considering an offer to settle within policy limits an excess default judgment).

language to the contrary in *Evans* was “simply a quotation from a treatise on insurance law, which treatise, although respected, does not correctly reflect the law of the state.” *Pritchard*, 140 Ga. App. at 350.

Great American Ins. Co. v. Exum, 123 Ga. App. 515, 181 S.E.2d 704 (1971), provided the Court with an opportunity to apply the equal consideration rule to a case in which the insurer refused to settle within policy limits prior to verdict and judgment. Citing *Evans*, *supra*, the Court articulated the insurer’s duty in deciding whether to accept an offer of settlement within the policy limits as the duty to “accord the interest of its insured the same faithful consideration it gives its own interest.” *Exum*, 123 Ga. App. at 519. Whether the insurer breached that duty is a jury question. *Id.* The Court held the *Evans*’ test would apply to the case at hand.

In *Exum*, the insured’s policy limit was \$10,000. While driving the insured car, the insured struck the plaintiff, a five-year old girl, as the plaintiff was attempting to cross the street. The plaintiff suffered permanent head and brain injuries. During the trial, the plaintiff rejected the defendant’s offer of \$7,500 but offered to settle the case for \$9,000. The defendant’s insurer refused. The jury returned a verdict for \$30,000. *Exum* sued his insurer for the amount which exceeded the policy limits. A jury found in favor of *Exum* against the insurer for the \$20,000 sought. In affirming the jury’s verdict, the Court of Appeals noted evidence that the insurer’s own attorneys considered the case “dangerous” and that the insurer had set a reserve of \$9,500. The insurer also admitted the insured had made a demand that it settle the case for \$9,000. While the insurer’s claims manager attempted to justify the refusal to settle by pointing out the absence of aggravating

circumstances such as intoxication, the Court held a jury question existed as to the insurer's breach, and the trial court did not err in overruling the insurer's motion for directed verdict.

The Duty to Inform the Insured of Settlement Offers

As the case law makes clear, the insurer's duties to its insured include the duty to notify the insured of any offers of settlement within the policy limits. A touchy situation arises when the insurer must be informed of its potential liability for failure to settle.

The Georgia Supreme Court addressed this issue in Formal Advisory Opinion No. 86-4 (December 17, 1987). The Court stated it is unethical and impermissible for a plaintiff's attorney to advise the defendant of such potential liability of the insurer. This communication would amount to "legal advice" to an adverse party. The proper person to advise the insured of the insurer's duties to him is the insured's attorney. "The problem here, of course, is that the attorney for the insured is also the attorney for the insurer. And given the context of representation, it seems clear that the insurer would prefer that the insured not be made aware of its duty to settle the claim in good faith." Formal Advisory Opinion No. 86-4. This dilemma, however, "is only apparent." *Id.* The insured's attorney has an ethical duty to keep the insured fully informed and this includes relaying any offers of settlement and "the potential liability of the insurer for a bad faith refusal to accept any reasonable offer within the policy limits." *Id.*

In support of its statement that the insured's attorney has a duty to keep the insured fully informed, the Georgia Supreme Court cited a case from Illinois, ***Rogers v.***

Robson, 81 Ill.2d 201, 407 N.E.2d 47 (1980). In this case, the insured was a physician named as a defendant in a medical malpractice suit. Although his liability policy apparently gave the insurer the right to settle the case without his consent, Dr. Rogers insisted he was not negligent and that the case not settle. The insurer, however, proceeded to negotiate a settlement. Dr. Rogers sued the insurer. The Appellate Court reversed the trial court's grant of the insurer's motion for summary judgment, and the insurer appealed. The Supreme Court of Illinois held that, although the insurer had hired Dr. Rogers' attorney to defend him in the malpractice action, Dr. Rogers was also the attorney's client "and was entitled to a full disclosure of the intent to settle the litigation without his consent and contrary to his express instruction." 81 Ill. 2d at 205. The duty to inform the insured of the intent to settle arose from the attorney-client relationship and was not affected by the insurer's right to settle the case without the insured's consent. Thus, in Georgia, it appears the duty to keep the insured fully informed includes not only the duty to inform the insured of settlement offers within the policy limits but also the insurer's intent to settle the case.

Time-Limited Offers of Settlement

Plaintiffs often make an offer of settlement and set a time limit for acceptance, and the question that may arise is whether the insurer acted in bad faith by refusing to settle within the time limit. The seminal case on this issue is *Southern General Ins. Co. v. Holt*, 262 Ga. 267, 416 S.E.2d 274 (1992). In this case, the plaintiff's attorney made a time-limited settlement offer for policy limits of \$15,000. The plaintiff's attorney

advised the insurer the plaintiff's medical bills totaled more than \$10,000 and the lost wages exceeded \$5,000. The letter included a doctor's report indicating the plaintiff had a herniated disc, and included medical bills totaling over \$6,000. The plaintiff's attorney later sent proof of additional expenses of over \$4,000. In a last letter to the insurer, the plaintiff's attorney extended the offer to settle within policy limits for five additional days and included in the letter a certified copy of the plaintiff's complete medical records. The insurer neither sought more time to evaluate the claim nor responded to the offer before it expired. The insurer offered to settle the case within limits only after the plaintiff's attorney had withdrawn the offer. A jury returned a verdict in favor of the plaintiff for \$82,000. The insured assigned to the plaintiff her claim against the insurer for negligent or bad faith refusal to settle within the policy limits. The plaintiff in this suit sought the excess of \$67,000, plus interest.

In the affirming the judgment for the amount of excess, the Georgia Supreme Court first noted the insurer may be liable to its insured for failing to settle a claim "where the insurer is guilty of negligence, fraud, or bad faith." 262 Ga. at 268. While reiterating the equal consideration rule, the Court further stated "[a]n insurance company does not act in bad faith solely because it fails to accept a settlement offer within the deadline set by the injured person's attorney." *Id.* at 269. The Court, however, rejected the insurer's argument "that an insurance company has no duty to its insured to respond to a deadline to settle a claim within policy limits when *the company has knowledge of clear liability and special damages exceeding the policy limits.*" *Id.* (emphasis in the original). The Court found the insurer did more than simply fail to settle within the time

frame set by the plaintiff's attorney. The insurer had information, including medical bills and documented lost wages, which showed special damages alone exceeded the limits of the insured's policy. The insurer's claims representative acknowledged he had the information, but he testified he needed medical documents to support it. The Court noted, however, that neither the claims representative nor the claims manager requested an extension of time to evaluate the plaintiff's claim. Thus, there was some evidence for the jury to conclude the insurer did not give equal consideration to the interest of its insured.

In 2003, the Georgia Supreme Court applied the principles of *Holt* to a case involving multiple defendants and a *conditional* offer of settlement. In *Cotton States Mut. Ins. Co. v. Brightman*, 276 Ga. 683, 580 S.E. 2d 519 (2003), Cotton States insured Defendant Martin under an automobile liability policy with limits of \$300,000. In August 1992, Defendant Cumbo was driving Martin's van when it struck the plaintiff who was turning left in an intersection. Although investigating police officers testified Cumbo was driving 58 to 65 mph in the 45 mph zone, that there was a strong smell of marijuana in Cumbo's van at the time of the collision, and Cumbo was later charged with driving under the influence, they also testified the collision was caused in part by the plaintiff's failure to yield the right-of-way.

In January 1994, the plaintiff's attorney wrote Cotton States and offered to settle the claims against Martin and Cumbo for the policy limits of \$300,000. This letter noted the plaintiff had sustained traumatic brain injury and included medical bills which totaled over \$329,000. Cotton States declined to settle at that time. In January 1995, a non-

binding arbitration panel found in favor of the plaintiff with \$2 million in damages. On January 30, 1995, the plaintiff made a final offer to Cotton States to settle the case for \$300,000 “contingent upon State Farm [Cumbo’s insurer] also tendering its limits of \$100,000.” 276 Ga. at 684. The offer was to remain open for 10 days. Cotton States and State Farm both failed to tender their limits within the 10 days. On March 17, 1995, however, Cotton States offered to pay its limit of \$300,000. Plaintiff rejected the offer.

At trial, the jury awarded the plaintiff almost \$1.8 million. Defendant Martin assigned her bad faith claim against Cotton States to the plaintiff, and the plaintiff sued Cotton States to recover the excess judgment of \$1,387,500. The jury returned a verdict against Cotton States for more than \$2.1 million. Both the Court of Appeals and Supreme Court affirmed this verdict.

The Georgia Supreme Court framed the issue as “whether Cotton States is excused, as a matter of law, from tendering its policy limits because the plaintiff’s demand contained a condition over which Cotton States had no control.” *Id.* at 685. Citing *Holt, supra*, the Court held that “the insurer had a duty to its insured to respond to the plaintiff’s deadline to settle the personal injury claim within policy limits when the insurer had knowledge of clear liability and special damages exceeding the policy limits.” *Id.* at 685. The Court cited the general rule that an insurer’s bad faith “depends on whether the insurance company acted reasonably in responding to a settlement offer.” *Id.* The Court considered the additional issues of multiple insurers and a conditional offer of settlement. The Court rejected Cotton States’ argument that, as a matter of law, it cannot be liable for failing to offer its policy limits and settle when the demand

contained “a condition beyond its control.” *Id.* at 686. The Court held that the proper response would have been for Cotton States to simply put its money on the table. “If Cotton States had tendered its policy limits while the plaintiff’s offer was pending, it would have done everything within its control to accept the plaintiff’s offer and thus protect its policy holder from an excess verdict.” *Id.* The Court found ample evidence to support the jury’s verdict, including the officer’s testimony that defendant Cumbo was at least partially at fault, plaintiff’s damages exceeding the limits of the liability policy, and the arbitration panel’s award of \$2 million in plaintiff’s favor. *Id.* at 687.

In *Kingsley v. State Farm Mut. Auto. Ins. Co.*, 353 F. Supp. 2d 1242 (N.D. Ga. 2005), the U.S. District Court considered whether a plaintiff must make a demand for policy limits before an insurer can be held liable for tortious refusal to settle. After reviewing Georgia law, including *Brightman*, *supra*, and *Thomas v. Atlanta Cas. Co.*, 253 Ga. App. 199, 558 S.E. 2d 432 (2001), the District Court found the law was unclear and, for purposes of summary judgment, the Court then assumed the plaintiff did *not* have to show she offered to settle within policy limits. The Court held, however, that a plaintiff must show the insurer knew or reasonably should have known that a policy limits settlement was possible and the insurer failed to effect the settlement. There must be “some certainty regarding the settlement posture of the parties,” such as clear liability, excessive damages, and “something that puts the insurer on notice that it must respond or risk liability for an excess judgment.” *Kingsley*, 353 F. Supp. 2d at 1252. The Court noted liability will be rare without a showing of an actual offer of settlement.

Excess Coverage

An insurer may be liable for the negligent or bad faith refusal to settle a case within the policy limits even though the insured is also covered by a liability policy providing excess coverage. In that situation, the excess insurance carrier is equitably subrogated to the rights the insured may have against the primary insurance carrier.

Home Ins. Co. v. North River Ins. Co., 192 Ga. App. 551, 385 S.E.2d 736 (1989). Thus, the excess carrier may sue the primary carrier for breach of the duty to exercise the requisite care in deciding whether to settle within policy limits. This case warrants a close examination because the facts and legal discussion offer important lessons to insurers in evaluating claims and weighing the risks of proceeding to trial.

In *Home Ins. Co.*, the plaintiff was the excess carrier and the defendant was the primary carrier in an action for negligent failure to settle claims and for misrepresentation of primary coverage. Home provided \$500,000 per occurrence coverage to a chemical company called Intex. North River provided excess coverage to Intex. The underlying case arose from Intex's sale of industrial solvent to Diamond Manufacturing Company. A Diamond cleaning crew used the solvent to clean fuel tanks on a tugboat. The cleaning crew was overcome by fumes from the solvent, and a total of twenty-six persons received medical attention as a result of breathing the fumes. Intex notified Home of the incident. Although several cross checks of coverage followed, Home mistakenly noted coverage limits of \$500,000 for each person and \$1 million aggregate for each accident. The policy actually provided coverage of \$500,000 for each incident and \$1 million aggregate for all occurrences during the policy period.

After three Diamond employees filed lawsuits against Intex, Home wrote Intex and advised the policy afforded coverage of \$500,000 for each person and \$1 million aggregate for each accident. North River relied on these assertions of coverage. Although North River had “some concern” that the verdicts of the Diamond employees’ lawsuits might exceed \$1 million, North River did not participate in any settlement discussions because offers of settlement were within the stated limits of \$1 million. “Thus lulled into a passive posture, plaintiff took no part in the defense or settlement negotiations concerning the...cases and allocated a reserve of only \$1 for each claimant.” 192 Ga. App. at 553.

The three underlying cases moved toward trial. The attorney hired by Home to represent Intex recommended authority of \$600,000 to settle the three cases. Home authorized only \$400,000. After the trial judge consolidated the three cases for trial, Intex’s attorney warned Home that defeat at trial was even more likely now because testimony from all three underlying plaintiffs would show the similarities of the injuries and bolster their creditability. The attorney recommended settlement for \$705,000. Home offered only \$225,000 initially and then, during trial, \$400,000. These offers were refused. The jury returned verdicts totaling \$1,250,000.

Following the trial, Home finally discovered its mistake concerning coverage. Home then asked North River to pay all of the judgment exceeding \$500,000. North River protested, of course, and offered to submit the dispute to arbitration. Incredibly, Home refused even this offer. North River then filed suit against Home. After a bench trial in the State Court of Chatham County, the Court awarded judgment in favor of North

River in the amount of \$494,871 special damages, \$190,525 prejudgment interest, and \$53,081 for the expense of litigation.

The Court of Appeals reversed and remanded the case because at least part of the judgment was predicated on the trial court's erroneous conclusion that North River could recover as subrogee of Intex's right to recover for the misrepresentation as to the amount of coverage. The Court held North River's claim based on the false representations was subject to any defenses which could have been used against Intex. Intex had a duty to read its own policy and was charged with knowledge of the terms of the policy, including the policy limits.

The Court found no error, however, in the trial court's conclusion that Home was negligent in its handling of the litigation and the settlement negotiations. The Court agreed North River was properly subrogated to the rights of Intex as to any claims for the negligent failure to settle the case within policy limits. The issue was one of the first impression in Georgia, and the Court explained the policy supporting equitable subrogation by the excess carrier:

[P]lacing the excess insurer in the shoes of the insured advances the public interest in obtaining prompt and just settlement of claims. The existence of excess or umbrella coverage must not relieve the primary insurer of its responsibility to accept reasonable settlement offers lest, in those situations where a claim exceeds the amount of primary coverage, the primary insurer be encouraged to attempt to place its financial burden upon the excess insurer.

Id. at 555. Specifically, the Court agreed Home was negligent in failing to change its trial strategy following the trial court's announcement that the three underlying cases would be consolidated: "[T]hat the changes in federal court procedure caused a

significant increase in the probable verdict against Intex was authorized by the evidence.”
Id. at 557.

The Court also held, however, that North River was not entitled to the entire amount of excess over the underlying limits of \$500,000. The Court agreed with the trial court that North Rivers’ damages were reduced by \$205,000 because the underlying plaintiffs’ last demand was \$705,000 and, thus, “some payment for the liability of Intex by [North River] was inevitable.” *Id.* at 558.

Uninsured Motorist Coverage

An insurer providing uninsured motorists coverage cannot be liable to its insured for failure to settle the uninsured motorist claim within policy limits. *McCall v. Allstate Ins. Co.*, 251 Ga. 869, 310 S.E.2d 513 (1984). In this case, the insured made a claim under his uninsured motorist coverage, offered to settle within the policy limits, and, after the insurer’s refusal to settle and the return of a verdict in the insured’s favor in excess of the uninsured motorist limits, the insured filed suit against the carrier for bad faith refusal to settle. The Court of Appeals reversed the trial court’s denial of the insurer’s motion for summary judgment, and the Georgia Supreme Court affirmed the Court of Appeals.

Recognizing the long-standing rule that an automobile liability insurer may be liable for failure to settle a claim within policy limits, the Court held the policy behind the rule does not apply to an uninsured motorist insurer. “The reason for this rule is that the insurer ‘may not gamble’ with the funds of its insured by refusing to settle within the policy limits. . . [W]here, as here, the insured is making a claim against the insurance

company for injuries to the insured under the uninsured motorist provisions of the policy, the insurance company is not, by refusing to settle with the insured, gambling with funds of the insured.” *McCall*, 251 Ga. at 870-871.

Multiple Claims and Payment of Limits

In 1991, the Georgia Court of Appeals confronted for the first time the issue of whether an insurer may settle a portion of multiple claims, thereby depleting or exhausting policy limits to the detriment of remaining claimants. In *Allstate Ins. Co. v. Evans*, 200 Ga. App. 713, 409 S.E.2d 273 (1991), the Court answered in the affirmative. In this case, the insurer settled a number of claims arising from a multi-vehicle collision, leaving \$50,000 out of the \$300,000 per accident liability limits. Two remaining claimants went to trial and obtained verdicts for \$35,000 each. The insurer tendered its remaining \$50,000 of coverage. The two claimants brought an action against the insurer for the full amount of their judgments.

Looking to authority from other jurisdictions, the Court of Appeals agreed that an “insurer may, in good faith and without notification to others, settle part of multiple claims against its insured even though such settlements deplete or exhaust the policy limits so that remaining claimants have no recourse against the insurer.” 200 Ga. App. at 714 (citation and punctuation omitted). The Court explained the policy considerations behind its decision:

Were the rule otherwise, an insurer would be precluded from settling any claims against its insured in such a situation and would instead be required to await the reduction of all claims to judgment before paying any of them, no matter how favorable to its insured the terms of a proposed settlement

might be. Such a policy would obviously promote litigation and would also increase the likelihood, in many cases, that the insured would be left with a total adjudicated liability in excess of his policy limits.

Id. at 715.

The same rule applies to uninsured motorist carriers. *Walston v. Holloway*, 203 Ga. App. 56, 416 S.E.2d 109 (1992). In this case, the Court of Appeals held that an uninsured motorist carrier may in good faith settle a portion of claims to the detriment of other claims. The policy considerations explained in *Allstate Ins. Co. v. Evans*, *supra*, applied as well to uninsured motorist carriers. *Walston*, 203 Ga. App. at 57.

An insurer may settle a portion of multiple claims without even attempting to negotiate settlement of other claims. *Miller v. Georgia Interlocal Risk Mgmt. Agency*, 232 Ga. App. 231, 501 S.E.2d 589 (1998). In this case, the underlying coverage provided \$1 million in liability limits. The underlying defendants' insurer settled one claim for \$900,000. The remaining claimant sued the insurer and its servicing agent for bad faith, seeking punitive damages and the underlying verdict in excess of \$100,000. The Court of Appeals noted that the claimant did not allege \$900,000 was an unreasonable amount to pay the first claimant, "considering the severity of her injuries." 232 Ga. App. at 232. Instead, the claimant argued the insurer acted in bad faith because the insurer settled with the first claimant without even attempting to negotiate a settlement with him. The Court held this did not constitute evidence of bad faith. "Whether to evaluate claims for settlement one at a time or together is in the discretion of the insurer." *Id.*

Assuming the policy contains the requisite language, an insurer's duty to defend ends when it pays out its policy limits. *Scruggs v. Int'l Indem. Co.*, 233 Ga. App. 772,

505 S.E.2d 267 (1998). The insurer, however, may not “abandon the defense of the claim in mid-course to the prejudice of the insured.” *Gibson v. Preferred Risk Mut. Ins. Co.*, 216 Ga. App. 871, 456 S.E.2d 248 (1995) (citation and punctuation omitted).

How to Advise the Insured and the Insurer of Settlement Demands

This writer is unaware of any standard form letter to advise the insured client of the insurer’s duties and potential liability. Should the attorney advise the insured to *demand* that the insurer settle the case within the policy limits? Or should the attorney merely suggest the insured might do so? Considering the attorney for the insured is also the attorney for the insurer, as the Georgia Supreme Court stated in Formal Advisory Opinion No. 86-4, it appears the attorney is also obligated to advise the insurer of its potential liability. Again, must the attorney *demand* on behalf of the insured that the insurer settle the case, make a mild recommendation that it settle, or simply advise the insurer of its potential liability? Attached to this paper as Exhibit “A” is a sample letter to an insured advising her of a settlement demand and the insurer’s potential liability. As far as this writer knows, the exact language of the letter is in no way required but is offered merely as a suggested, if extreme, approach.

COVERAGE DISPUTES

It is fundamental that an attorney may not represent both the insured and the insurer in a coverage dispute.³ When the insurer elects to provide a defense for its insured, usually under a reservation of rights, the insurer must engage separate counsel to advise it on coverage and prosecute any declaratory judgment action. This portion of the paper will examine some of the rights and responsibilities — and potential liability — of the insurer when it elects to dispute coverage.

Refusing to Defend

The insurer may be liable for refusing to defend the insured or settle the case within the limits when the insurer insists there is no coverage under the policy. For example, in *Alexander Underwriters Gen. Agency, Inc. v. Lovett*, 182 Ga. App. 769, 357 S.E.2d 258 (1987), the insurer refused to defend its insured or pay the settlement demand because of its asserted position that the insurance policy had been cancelled. The “proper and safe course of action for an insurer in this position would have been to enter upon a defense under a reservation of rights and then proceed to seek a declaratory judgment in its favor.” 182 Ga. App. at 769. Here, the insurer instead chose to ignore the offer of settlement based on its position of non-coverage. The Court first found there was coverage and then remanded the case for the jury to decide whether the insurer had negligently or in bad faith refused to defend or settle the case. With the plaintiff’s policy

³ “A lawyer shall not represent or continue to represent a client if there is a significant risk that...the lawyer’s duties to another client...will materially and adversely affect the representation of the client... .” Georgia Rules of Professional Conduct, Rule 1.7.

limits at \$10,000, the jury returned a verdict in favor of the plaintiff in the amount of \$415,377 excess, \$25,000 in punitive damages, and \$22,500 in attorney's fees. The Court of Appeals affirmed the judgment. The Court found sufficient evidence to support the judgment. The Court also reaffirmed the insurer's liability may be based on bad faith *or* negligence. 182 Ga. App. at 777.

Reservation of Rights

Richmond v. Georgia Farm Bureau Mut. Ins. Co., 140 Ga. App. 215, 231 S.E.2d 245 (1976), remains the voice of guidance to the insurer in coverage dispute cases. Generally, when a liability insurer assumes the defense of a case against its insured, with knowledge of facts which might constitute non-coverage under the policy and without giving notice of its reservations or rights, the insurer is thereafter estopped from asserting any defense of non-coverage. *Richmond*, 140 Ga. App. at 217. To avoid an estoppel, the insurer may give "timely notice of its reservation of rights where such notice fairly informs the insured of the insurer's position." *Id.* Such a course of action protects the insurer even though the insured may not agree to the defense under the reservation of rights. *Id.* at 218. The Court declined to require the insured's consent to the defense under the reservation of rights. The rule requiring the insured's consent, although followed by the majority of jurisdictions, was "too inflexible to be either just or fair." *Id.*

The Court offered the following advice to insurers:

An insurer may not give an insured a unilateral notice of reservation of rights and thereupon proceed with a complete defense of the main claim absent insured's express or implied consent. This course of action may well result in prejudice to an insured. Upon learning of facts reasonably

putting it on notice that there may be grounds for non-coverage and where the insured refuses to consent to a defense under a reservation of rights, the insurer must thereupon (a) give the insured proper unilateral notice of its reservations of rights, (b) take necessary steps to prevent the main case from going into default or to prevent the insured from being otherwise prejudiced, and (c) seek immediate declaratory relief including a stay of the main case pending final resolution of the declaratory judgment action.

Id. at 219. By following this procedure, the insurer will preserve its right to contest coverage. Furthermore, in a declaratory judgment action, the insurer may raise additional grounds for non-coverage which were not raised in the reservation of rights letter.

Government Employees' Ins. Co. v. Progressive Cas. Ins. Co., 275 Ga. App. 872, 622 S.E. 2d 92 (2005).

The Insurer's Duty to Investigate and to Defend

In *Colonial Oil Industries v. Underwriters Subscribing to Policy Nos. T031504670 and T031504671*, 268 Ga. 561, 491 S.E.2d 337 (1997), the Georgia Supreme Court considered certified questions from the Eleventh Circuit concerning the insurer's duty to investigate prior to making a determination of coverage, and the effect of an insurer's wrongful refusal to defend. "We conclude that an insurer has no duty to investigate until the insured apprizes the insurer of facts that would bring the claim within the policy's coverage. We also conclude that an insurer who has wrongfully refused to defend may raise policy defenses to coverage." *Colonial Oil*, 268 Ga. at 561. In determining whether to defend a case, the insurer may base its decision on the allegations of the complaint and any facts supplied to the insurer by the insured. *Id.* at 562. "The insurer is under no obligation to independently investigate the claims against its insured.

This rule is sound policy because the insured is in the best position to investigate and develop facts that will bear on the coverage issue.” *Id.* When the insured informs the insurer of facts which may implicate coverage, however, the insurer must conduct an investigation into such facts. *Id.* “To relieve an insurer of any duty to investigate its insured’s contentions would allow the allegations of a third-party to determine the insured’s rights under its contract.” *Id.* When the insurer fails to investigate facts supplied to it by the insured and fails to provide a defense, the insurer will be liable for breach of the duty to defend “if a reasonable investigation at the time would have established the potential for coverage.” *Id.*

In *Colonial Oil*, the underlying complaint alleged the insured was liable for dumping hazardous material on the underlying plaintiff’s property. The insurer concluded coverage was excluded under a pollution exclusion. The insured, however, informed the insurer that the material dumped did not contain pollution. The Georgia Supreme Court agreed that this triggered the insurer’s duty to investigate and that a reasonable investigation would have revealed the possible existence of coverage. Therefore, the insurer breached its duty to defend.

The unjustified refusal to defend, however, did not prevent the insurer from raising policy defenses. The Court recognized that the duty to defend and the duty to indemnify are separate obligations. The Court explained that a wrongful refusal to defend entitles the insurer only to what is owed under the insurance contract, the cost of the defense. Breach of the duty to defend will not enlarge the indemnity coverage

beyond that provided in the policy. “The insured is in no better position to create coverage that was never bargained for under its contract.” *Id.* at 563.

In *Controlled Blasting, Inc. v. Ranger Ins. Co.*, 225 Ga. App. 373, 484 S.E.2d 47 (1997), the Court reiterated the rule that an insurer looks to the complaint to determine whether there is coverage under the policy and, thus, a duty to defend. Furthermore, the Court held that the “correctness of an insurer’s decision to defend or not cannot be determined by ‘later revealed facts’ of which the insurer has no knowledge or notice.” *Controlled Blasting*, 225 Ga. App. at 375 (citation and punctuation omitted). Thus, unless the complaint shows facts implicating coverage, the insured must supply the insurer with facts which implicate coverage and trigger the duty to defend at the time the defense is sought. See also *City of Atlanta v. St. Paul Fire & Marine Ins. Co.*, 231 Ga. App. 206, 498 S.E.2d 782 (1998) (the allegations of the complaint and the language in the policy determine the duty to defend, and the insurer has a duty to defend if the facts in the complaint “even arguably bring the occurrence within the policy’s coverage”).

Seeking Declaratory Judgment

As *Richmond v. Georgia Farm Bureau*, *supra*, instructs, the “proper and safe course of action” for the insurer seeking to resolve a coverage dispute includes the filing of a declaratory judgment action. *Richmond*, 140 Ga. App. at 217. The insurer must keep in mind, however, the general rule that declaratory judgment is unavailable when the insurer has already denied a claim. *Atlanta Cas. Co. v. Fountain*, 262 Ga. 16, 413

S.E.2d 450 (1992). Nevertheless, the Georgia Court of Appeals recently expanded an exception to this general rule.

In *Colonial Ins. Co. of California v. Progressive Cas. Ins. Co.*, 252 Ga. App. 391, 556 S.E.2d 486 (2001), Progressive sought a determination that its policy provided no coverage to its insured for damages arising from an automobile accident. The driver of the insured automobile was an unlicensed driver. Progressive brought its declaratory judgment action based on the unlicensed driver exclusion. The trial court granted Progressive's motion for summary judgment. On appeal, Colonial Insurance Company, the underlying plaintiff's uninsured motorist carrier, argued Progressive was estopped from seeking a declaratory judgment because it had previously denied its insured's claim for coverage. In response, Progressive argued the denial of coverage was a "qualified" denial because the denial letter stated the insurer would reconsider its position if the insured provided additional information bearing on the issue of coverage.

On appeal, the Court of Appeals held Progressive was not estopped from seeking declaratory judgment:

Progressive contends that the letter sent to [its insured] was a qualified refusal and subject to change. It further maintains that even if the letter was a strict denial letter, because Progressive undertook to defend the [insureds] in the underlying lawsuit under a reservation of rights, it is not estopped from seeking declaratory judgment. We agree with Progressive.

252 Ga. App. at 392. Thus, Progressive was entitled to seek declaratory judgment because of actions it took subsequent to its initial denial of coverage, i.e., providing its insured with a defense under a reservation of rights. The Court further stated: "We cannot say that 'having issued an original statement that it was not liable and would not

defend, it was forever precluded from a change of course.” *Id.* at 393 (quoting *State Farm Mut. Auto Ins. Co. v. Allstate Ins. Co.*, 132 Ga. App. 332, 208 S.E.2d 170 (1974)).

Because Progressive had reassessed its legal position and was defending its insured under a reservation of rights, and had thereby done more than “rest on its denial of coverage,” coverage was still in issue, and Progressive was entitled to seek declaratory judgment. *Id.* Thus, under *Colonial Ins. Co.*, *supra*, an insurer may issue a “qualified” denial of coverage and still preserve its right to seek declaratory judgment.

Colonial Ins. Co. also appeared to hold that, even if the insurer issues a strict denial with no qualifying language, it may still later seek declaratory judgment if it provides conditional coverage by defending its insured in the underlying action under a reservation of rights. The Georgia Supreme Court, however, ruled otherwise. In *Drawdy v. Direct General Ins. Co.*, 277 Ga. 107, 586 S.E.2d 228 (2003), the insurer, relying on the non-permissive driver exclusion, issued an unconditional denial of coverage for any claims arising from the accident. The insurer later filed a declaratory judgment action. The insured filed a Motion to Dismiss the declaratory judgment action, but prior to the trial court’s decision on this motion, the underlying claimants filed a lawsuit against the insured. The insurer then issued a qualified denial and entered into a defense of its insured under a reservation of rights. Nevertheless, the trial court dismissed the declaratory judgment action. The Court of Appeals reversed, holding the insurer’s actions were proper under *Colonial Ins. Co.*, *supra*. The Georgia Supreme Court in turn reversed the Court of Appeals and held the dismissal of the declaratory judgment action was proper.

The Court restated the general rule that declaratory judgment is not available when the insurer has already denied a claim or where a party merely seeks to test the viability of its position. The Court distinguished *Colonial Ins. Co.* by finding Direct General issued an unqualified denial and no underlying lawsuit was pending at the time it filed its complaint for declaratory judgment. An insurer may change its position after an initial denial of coverage only “where the insurer has both indicated its willingness to reconsider its insured’s claim and has positively demonstrated that it considers the question of coverage to still be an issue.” 277 Ga. at 109.

CONCLUSION

The automobile liability insurer and the insured’s attorney must be constantly aware of potential conflicts in the attorney’s representation and the insurer’s potential liability for failure to settle a case within policy limits or failure to defend its insured. The insurer must also be cognizant of potential coverage disputes and its obligations to its insured when coverage disputes arise.

The failure of an insurer to perform its good faith duty to settle a claim within policy limits may subject the insurer to liability for any excess judgment. The insurer must give equal consideration to the interests of its insured. The insurer must not take unreasonable risks and gamble with the insured’s funds. The question of an insurer’s negligence or bad faith in refusing to settle is usually a question for the jury.

The insurer’s duty to its insured includes the duty to inform the insured of all offers of settlement. When an offer of settlement is within the policy limits, the insured’s

attorney must inform the insured of the offer — and inform both the insured and the insurer of the insurer's potential liability for bad faith refusal to settle. The attorney's duties apparently include the duty to inform the insured of the insurer's intent to settle; certainly that duty exists when the insured objects to settlement. The insurer may be liable for bad faith refusal to settle if the insurer fails to meet a time deadline for acceptance imposed by the plaintiff's attorney. At a minimum, the insurer must seek an extension of the deadline to properly assess the claim and the offer of settlement.

The insurer's duty to exercise good faith in determining whether to settle or proceed to trial is not affected by the presence of excess insurance coverage. The excess carrier is equitably subrogated to any rights of the insured against the insurer for negligent or bad faith failure to settle. The insured may not maintain such an action, however, against his own uninsured motorist carrier.

When multiple claims exist, an insurer may settle a portion of the claims to the detriment of the remaining claimants. Furthermore, if there is no prejudice to the insured, an insurer's obligation to defend ends when the policy limits are paid out.

The duty to defend and the duty to indemnify are separate and independent obligations under the liability policy. In determining whether to provide a defense, the insurer must look to the facts alleged in the complaint and consider any additional facts presented by its insured. Facts that even arguably bring the claim within the coverage obligate the insurer to provide a defense. Absent such facts, however, the insurer is under no obligation to conduct an independent investigation of the claims alleged in the complaint.

Finally, when coverage disputes arise, the recommended course of action is to provide a defense under a reservation of rights and seek declaratory judgment. Prior denial of a claim usually precludes the filing of a declaratory judgment action. If the insurer issues a “qualified” denial, however, it may still seek declaratory judgment provided it defends its insured in the underlying action under a reservation of rights.

EXHIBIT A – SAMPLE LETTER

Ms. Insured Driver
96 Negligence Way
Atlanta, GA 30309

Re: *Whiner v. Driver*

Dear Ms. Insured Driver:

On June 21, the attorney for the Plaintiff in the above-mentioned case made a settlement demand on behalf of Mr. Whiner in the amount of \$21,000. This constitutes a demand to settle this lawsuit within your policy limits. In the event a judgment were rendered in this case which exceeds your policy limits, you could be personally liable for that excess amount. Therefore, should you choose to do so, you may make a demand upon Tight Wad Insurance Company to settle this case within your policy limits of \$25,000. It is in your best interest this case be resolved within your policy limits, as it would protect you from any exposure of your personal assets. If you wish to make a demand upon Tight Wad Insurance Company that it settle this case within your policy limits, you should make such a demand as quickly as possible by writing to Harry Hamfisted at Tight Wad Insurance Company, 48 Bad Faith Road, Need Help, Alabama. If you cannot make this demand in writing, you should call Harry Hamfisted at 205-000-0000 to discuss this matter with him. If you prefer I communicate such a demand to Tight Wad on your behalf, please let me know and I will do so.

In the event you make a demand upon Tight Wad Insurance Company to settle this case within your policy limits and Tight Wad refuses to do so, you may be able to later assert Tight Wad failed to act reasonably and/or in good faith on your behalf to protect you from a judgment which exceeded your policy limits.

You have the right to retain an attorney to advise you on these matters. The retention of any such attorney would be at your own expense, but I would be happy to work and cooperate with any such attorney you might choose to retain. If you have any questions, please do not hesitate to call me.

Sincerely,

Joe Cool, Esq.