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Illinois Coverage Basics

Surprising Developments Affecting Insurers' Duty to Settle

More than a decade ago, the Illinois Supreme Court established that an insurer can be liable for bad faith if it fails to reasonably settle a claim against its insured within its policy limits. See Cramer v. Insurance Exchange Agency, 174 Ill.2d 513, 675 N.E.2d 897 (1996). A finding of bad faith can expose an insurer to a judgment in excess of its policy limits and also subject it to punitive damages. So, it is important for insurers to understand when the duty to settle is triggered and what that duty requires. The Illinois cases may surprise you.

A recent decision from the Northern District of Illinois purports to redefine liability insurers' duty to settle. The District Court's ruling in Bashaw v. American Family Mutual Insurance Co., 2006 WL 3591318 (N.D.Ill. 2006) challenges bedrock assumptions of liability claims handling under Illinois law:

- Does an insurer have a duty to negotiate if no demand has been made?
- Does an insurer have a duty to bid against itself if a claimant refuses to negotiate?
- Can an insurer rely on the opinion of counsel regarding the value of a claim?

In Haddick v. Valor Insurance, 198 Ill.2d 409, 763 N.E.2d 299 (2001), the Illinois Supreme Court ruled that a duty to settle may arise even before a demand has been made against the insured. The Court in Haddick ruled that although insurers generally are not required to initiate settlement negotiations, an exception exists as to claims for which there is a reasonable probability of a finding against the insured in excess of the policy limits. Haddick established that an insurer's duty to settle may be triggered even before a claim is made or a suit is filed against the insured, if there is a reasonable probability that damages will be awarded against the insured in excess of the policy limits on a claim. After Haddick, insurers could no longer delay consideration of settlement until they received notice of a claim or suit.

The recent District Court ruling in Bashaw pushes the duty to settle standard far beyond the framework of Haddick. Beginning with the Haddick analysis, the District Court in Bashaw reconfirmed that an insurer's duty to settle may arise even before a suit is filed or a claim is made against its insured. However, the Bashaw court went on to radically redefine what a liability insurer must do once that duty has been triggered. The Bashaw opinion holds that an insurer may have an ongoing duty to continue negotiations, even if a plaintiff refuses to respond to the insurer's offers. The Bashaw opinion also holds that an insurer may have a duty to pay its policy limits, even if defense counsel evaluates a claim well within the policy limits.

The groundbreaking rulings in Bashaw arise from an unremarkable factual foundation. American Family Mutual Insurance Company insured Teri Bashaw for auto liability with a policy limit of $100,000. After Ms. Bashaw was involved in an auto collision, American Family acknowledged coverage and assigned defense counsel. Defense counsel reported that the claimant had $16,000 in medical expenses, and the insurer's claims adjustment program placed the gross settlement value in the range of $30,000 to $35,000. Defense counsel opined that a jury would find Bashaw 100% liable and recommended a settlement in the range of $30,000 to $40,000. The two American Family adjusters who worked on the file believed the verdict range to be in the area of $30,000 to $50,000. The judge recommended that the case should be settled in the range of $50,000 to $70,000, and he predicted a verdict in the range of $70,000 to $90,000.

American Family had offered $15,500 to settle the claim long before trial, but the plaintiff refused to respond with a counterdemand. During the trial, American Family told defense counsel that it would be willing to increase its offer if plaintiff showed any movement. However, plaintiff never engaged in negotiations with the insurer, and the jury ultimately returned a verdict against Ms. Bashaw in the amount of $585,390.

The District Court in Bashaw considered the probability of an excess verdict as one elements in its evaluation of Ms. Bashaw's bad faith claim against American Family. The court acknowledged that no person other than the plaintiff's attorney had ever estimated the settlement value or verdict potential either equal to or in excess of the $100,000 policy limit. It also acknowledged that the only information that American Family had that the damages could exceed the policy limit came solely from the claimant's own evaluations of the claim. Nevertheless, the court found that there was a reasonable likelihood of an excess verdict, because the valuations of the claim had generally increased over time as the case neared trial. Although it was undisputed that no one had ever valued the case at or above $100,000, the court ruled that an excess verdict was sufficiently likely to support a bad faith claim against American Family.

The court in Bashaw also considered the insurer's willingness to negotiate as an element in its evaluation of Ms. Bashaw's bad faith claim. It was undisputed that the plaintiff refused to make a counterdemand after American Family made its initial settlement offer of $15,500. The insurer explained its decision not to offer more money to the plaintiff on the basis that it did not wish to "negotiate against itself." However, the Bashaw court held that American Family's explanation of its settlement position was insufficient to protect it from a claim that it had unreasonably refused to negotiate. Based upon the general upward trend of the claim valuations, coupled with the substantial amount of the ultimate verdict, the Bashaw court determined that the insurer should at some point have moved up from its $15,500 offer, even though the plaintiff had steadfastly refused to respond with a counteroffer.

At present, the Bashaw opinion is not binding authority, because it is not yet a case dispositive ruling and has not been appealed. However, it is authority that can be cited to support future arguments seeking to expand insurers' duty to settle in Illinois.

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If you have questions or would like to discuss the implications of this report further, please feel free to contact James K. Horstman at Cray Huber Horstman Heil & VanAusdal LLC, 303 West Madison Street, Suite 2200, Chicago IL 60606; 312-332-8494; jkh@crayhuber.com.