BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
White and Williams LLP
Randy J. Maniloff
maniloffr@whiteandwilliams.com

Please see below for a note about *Binding Authority*.

August 9, 2010

Betting The Rova Farm: Rejecting A Demand To Settle Within Limits

New Jersey Appellate Division Takes A Bite Out of Insured's Bad Faith Case

We are all familiar with products that have taken on a generic meaning: Kleenex, Xerox and Band-Aid to name but a few. I was in my early 30s before I realized that Jello-O was a brand and what I'd been eating all those years was this product called gelatin.

Sometimes insurance coverage cases also take on a generic meaning. For example, *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y* is a California decision -- but use the term "Cumis Counsel" in coverage circles anywhere and everyone will know what you mean. *Buss v. Transamerica Ins. Co.* also comes from California. But simply say "Buss," in any zip code, and you'll leave no doubt about the principles to which you are referring.

In New Jersey, a coverage case that has taken on a generic meaning is *Rova Farms* -- on account of its so-called "Rova Farms Letter." [Note: Even if New Jersey is not a jurisdiction of interest for you, what's at issue in a Rova Farms Letter, and the lesson that comes from the following case summary, apply in every state in the country.] A Rova Farms Letter is at the heart of one of the most challenging issues that insurers face. It goes like this:

An insurer has been defending a case. It is a significant one and the damages have the potential to exceed the limits of the insured's policy. Trial is approaching. A demand is made by the plaintiff to settle the case within the insured's limits of liability. The insured is demanding, probably adamantly, that the insurer settle -- to eliminate any potential for the insured to have personal exposure if the verdict exceeds the policy limits. The insured has made it clear that, if the insurer fails to settle, the insured will look to the insurer to pay the entirety of the verdict. When in New Jersey, this demand to settle is

conveyed by the insured to the insurer in what is commonly called a "Rova Farms Letter," named after the leading case to address the issue. In West Virginia the same demand comes by way of a Shamblin Letter. And in Texas it's a Stowers Demand. And so forth.

Back to the settlement scenario. Defense counsel is advising the insurer that, while the case has viable defenses to liability, and perhaps elements of comparative negligence, and the damages may be inflated, the possibility of a large verdict still can not be eliminated. For this reason, defense counsel recommends that the insurer accept the settlement offer. The insurer has round-tabled the case and sees it differently and is not prepared to offer its full limits in settlement. The case proceeds to trial and the jury comes back with a verdict that exceeds the limits of liability – perhaps by a lot. A demand is now made on the insurer to pay the full amount of the verdict, on the basis that its rejection of the settlement demand, within the policy's limits of liability, was done in bad faith, and, hence, the insurer is now responsible for the entire verdict. The insured assigns the bad faith claim to the underlying plaintiff in exchange for a covenant not to execute against the insured's personal assets. The underlying plaintiff, as assignee, files a bad faith suit against the insurer.

We've all been at some stage in this process. It plays out everyday in claims departments across the country. Deciding how to respond to a settlement demand within policy limits, for a case that really could exceed the policy limits, is the rubber-meets-the-road moment for insurance companies.

In *Wood v. New Jersey Manufacturers Ins. Co.* (New Jersey Appellate Division; July 28; Unpublished), the insurer was confronted with a demand to settle a case within the insured's limits of liability. The insurer declined. The case went to trial. The verdict greatly exceeded the policy limits. You know where this is going. Here's the full story…

Karen Wood was a U.S. Postal Service letter carrier. While delivering mail she was attacked by a dog named Max. It was the sixth time that Max had charged at her while she was delivering mail. [Sweet, fluffy, Max, who means no harm and can't help it if he gets too excited when saying hello to people vs. U.S. Postal Service employee. I need to know more details before I can decide who's at fault here.] Wood eventually needed two spine surgeries and maybe a third. She filed suit against the dog's owner, his grandmother, in whose home the dog was living, and what appears to be a homeowner's association.

New Jersey Manufacturers issued a liability policy to the grandmother that included her grandson as an insured. The policy had a $500,000 limit of liability. NJM defended the grandmother and grandson. Max demanded independent counsel.

Wood indicated that she was willing to settle the case at or below NJM's $500,000 policy limit. NJM's highest settlement offer was $300,000. Wood's attorney sent two "Rova Farms Letters" (specifically called that name by the court), stating that the $300,000 offer was made in bad faith and if Wood obtained a verdict in excess of $500,000 she would look to NJM for the excess verdict. Counsel for the grandmother also sent a similar Rova Farms Letter to the insurer, demanding that it negotiate in good faith and use its best efforts to settle the case within the $500,000 policy limit.

To try to make a long story short (the opinion is 44 pages), some of the salient facts at issue, at the time of the insurer's decision whether to settle or try the case, were as follows:

- NJM and Wood sharply disputed the nature and extent of Wood's injuries and to what degree they had been caused by Max's attack;
- Non-compromisable workers comp. lien (medical reimbursements and disability payments) was on its way to hitting $400,000;
- Wood's economist placed her past and prospective economic loss at $561,000;
- Court appointed arbitrator, pre-trial, evaluated Wood's economic and non-economic damages at $600,000 and allocated 90% to the grandmother and 10% to the homeowner's association (i.e., $540,000 verdict against the grandmother);
- NJM's adjuster concluded that the value of the case was in the $500,000 range, especially if the jury resolved the causation issue in Wood's favor;
- Defense counsel recommended that NJM release the $500,000 policy limit to him in settlement authority, noting that the value of the case will exceed the insured's policy;

NJM's Major Claims Committee was more optimistic than defense counsel. In making its decision to limit its offer to $300,000, the court described the Committee's thinking as follows:

> In making its evaluation, the Committee apparently found several factors were significant. Among other things, the Committee perceived that Wood had been untruthful in her interrogatory answers and at her deposition, in contending that
> she had experienced no neck injuries prior to the March 2001 dog
> attack. In fact, there was contrary medical documentation

> showing that Wood had been previously treated for neck injuries and that the pre-existing neck condition was chronic. The Committee also regarded as significant the fact that Dr. Dennis, Wood's expert from the compensation case, had reversed his opinion about the causal linkage between the March 2001 incident and Wood's cervical condition. The Committee also had a more optimistic view of its insureds' liability exposure. The Committee noted that despite repeated complaints to AVMA about the dog, the association apparently took no action to address the situation. The Committee therefore predicted that AVMA would be allocated "a significant portion of liability" by the jury, thereby reducing the comparative exposure of NJM's insureds.

Wood at 8.

The case proceeded to trial. During the trial, the court made several rulings that the Appellate Division characterized as adverse to NJM's insureds. Before the jury began deliberations, Wood dropped her settlement demand to $450,000. NJM did not make a counter-offer.

The jury came back with an award in the amount of $2,422,000 and apportioned liability 51% to the grandmother and 49% to the homeowner's association. Following a molding of the verdict for the comparative fault, and adding appropriate interest, final judgment was entered against NJM's insured in the amount of $1,408,320.33. NJM paid the $500,000 policy limit to Ms. Wood and her husband. The Woods and the insureds negotiated an assignment of the insureds' potential bad faith claim.

Now to the bad faith suit, referred to by the court as a "Rova Farms action," in which the Woods' sought to recover the amount of the judgment in excess of $500,000. The trial court ruled on summary judgment that NJM's failure to settle the case was in bad faith. The case was appealed to the Appellate Division – with the involvement of several *amicus* parties. The Appellate Division reversed.

The Appellate Division began with a history lesson in New Jersey's third-party bad faith law, which culminated in the Supreme Court's 1974 decision in *Rova Farms, Inc. v. Investors Ins. Co.* The *Wood* court described *Rova Farms* as follows:

> "[A] decision not to settle must be a thoroughly honest, intelligent and objective one. It must be a realistic one when tested by the necessarily assumed expertise of the company."
> Id. at 489-90 (quoting Bowers v. Camden Fire Ins. Ass'n, 51 N.J. 62, 71 (1968)). The Court further explained that:
>
> [t]his expertise must be applied, in a given case, to a consideration of all the factors bearing upon the advisability of a settlement for the protection of the insured. While the view of the carrier or its attorney as to liability is one important factor, a good faith evaluation requires more. It includes consideration of the anticipated range of a verdict, should it be adverse; the strengths and weaknesses of all of the evidence to be presented on either side so far as known; the history of the particular geographic area in cases of similar nature; and the relative appearance, persuasiveness, and likely appeal of the claimant, the insured and the witnesses at trial.

Id. at 26-27 (*quoting Rova Farms*).

Applying the circumstances before it to the *Rova Farms* standard, the Appellate Division in *Wood* held that:

> Having independently reviewed the record, we are persuaded
> that the trial court here acted too swiftly in granting summary
> judgment to plaintiffs on the question of NJM's alleged bad faith. Although we appreciate many of the critcisms leveled by
> plaintiffs against NJM about its inflexible settlement position
> prior to the jury's verdict, we do not share the trial court's
> confidence at least on this paper record that the proofs compel

> a conclusion that NJM was "actually dishonest, unreasonably optimistic or otherwise [acting] in bad faith, or infected with negligence such as to impede the reaching, or having the capacity to reach, a 'good faith' decision." Rova Farms, supra, 65 N.J. at 497.

Id. at 31.

The *Wood* Court then went on for about 5 pages explaining why NJM's decision not to settle may not satisfy the bad faith standard set out in *Rova Farms*. The court's analysis in this regard, which is both a critical component of its decision, as well as a major take-away from the case, is set out at pages 31-36 (attached). Given the importance of this aspect of the case, I direct you to the court's actual opinion and not any summary that I could provide.

While the Appellate Division in *Wood* reversed the trial court's bad faith finding, it did not conclude that NJM did not act in bad faith. The court's decision was that "summary judgment was prematurely granted to plaintiffs on the bad faith issues. There are genuine fact-sensitive determinations that need to be made about the reasonableness of NJM's handling of settlement negotiations in the underlying tort action. That assessment of reasonableness will hinge, to some degree, upon the credibility and persuasiveness of fact witnesses. It may also depend upon the testimony of expert witnesses opining about what went wrong here on the settlement front and why it went wrong. Prudence dictates that these pivotal questions of reasonableness and bad faith be decided in this case after a full-blown evidentiary presentation before the factfinder." *Id.* at 35-36.

The lesson from *Wood* is a simple one – be it New Jersey or most states. On one hand, no insurer that declines to settle a case within its insured's limits of liability wants to confront an excess verdict. No matter how thorough and reasoned the insurer's pre-trial decision not to settle may have been, the fact is that such decision will now be judged using a proof-is-in-the-pudding standard. In other words, because the verdict did in fact exceed the policy's limits of liability, then, by definition, it could have exceeded such limits.

On the other hand, as *Wood* demonstrates, *Rova Farms* does not impose a strict liability standard on an insurer for its failure to settle within policy limits (*Wood* said so specifically). Simply because an insurer declines to settle a case within policy limits,

even if it was sent a so-called Rova Farms Letter, does not *per se* make it liable for an excess verdict. And this is the rule in most states (recognizing that the standards for establishing bad faith can vary significantly between jurisdictions). Whether an insurer's decision not to settle a case, despite an offer to do so within policy limits, was made in bad faith, requires resort to a lot more facts than simply comparing the pre-trial demand to the eventual verdict.

Plaintiffs and policyholders like to maintain that an excess verdict, in and of itself, is the end of the story as far as the insurer's liability for the entirety of such verdict is concerned. But as *Wood* teaches, while it is not an enviable position for the insurer, an excess verdict can be just the beginning of the bad faith story.

A copy of the New Jersey Appellate Division's July 28, 2010 decision in *Wood v. New Jersey Manufacturers Ins. Co.* can be accessed here:

http://www.judiciary.state.nj.us/opinions/a1768-08.pdf

If you have any questions, please let me know.

Note About *Binding Authority*: If you are receiving *Binding Authority* for the first time, it is likely because you registered for the White and Williams Coverage College. Information about *Binding Authority*, and an archive of back issues, can be accessed here:

http://www.whiteandwilliams.com/CM/Custom/Newsletters.asp

If you do not wish to receive future issues, please reply with Unsubscribe in the subject line. I won't be insulted.

Please let me know if you have any questions.

Randy

Randy J. Maniloff
White and Williams LLP
1800 One Liberty Place | Philadelphia, PA 19103-7395
Direct Dial: 215.864.6311 | Direct Fax: 215.789.7608
maniloffr@whiteandwilliams.com