

London Practice Law Update

07/11/2011

Washington Court of Appeals Breaks New Ground in Insurers' Duties When Handling Third-Party Liability Claims Before the Insured is Sued

SYNOPSIS

On July 5, the Washington Court of Appeals issued its decision in *Tarutis v. Farmers Insurance*, concerning an insurer's duty to accurately adjust claims and settle within policy limits. The Court held that the insurer breached its duty of good faith and fair dealing by failing to attempt to settle a claim against its insured prior to suit being filed against the insured. It also held that the insurer's subsequent tender of policy limits after suit was filed against the insured did not cure this breach. As a result, the insurer was exposed to liability far in excess of its policy limits.

THE FACTS

This bad faith action arose out of a tragic fire at a rental home owned by the insured that caused extensive burn injuries to a toddler. The fire was caused by a candle left unattended, but was not immediately detected because the house had no working smoke alarms, as required by law. Representatives of the toddler hired an attorney who contacted Farmers Insurance ("Farmers") directly and made several demands, including information concerning policy limits. Farmers declined to provide the information and told the attorney that the insured was not negligent and that it was closing its file. Claimant's counsel again requested insurance information, explained to Farmers the law concerning working smoke detectors, and informed Farmers that medical expenses were nearly \$800,000. Although this amount was well in excess of the Farmers \$100,000 policy limits, Farmers apparently did not communicate this information to its insured.

Claimant's counsel asked Farmers if he should send a proposed "settlement package" to Farmers, but Farmers responded that its decision concerning liability was final and not to bother. The claimant then filed suit. Farmers defended the insured, and after a new adjuster was assigned, tendered its policy limits to settle the case. This offer was rejected. The underlying case was eventually settled when the claimant accepted \$600,000 of the insured's own funds and a confession of judgment for \$17 million, together with a covenant not to execute on the insured's property and an assignment of the insured's rights against Farmers. The claimant then brought the instant coverage action.

DISCUSSION

The Washington Court of Appeals first held that the bad faith claim was not barred by the statute of limitations because it accrued at the time the insured suffered an adverse judgment and was filed within the applicable three-year period thereafter. Next, the Court held that Farmers' duty to settle the case within policy limits arose before suit was filed against the insured. Several aspects of this holding are significant. First, Washington imposes a duty to settle within policy limits where liability has become reasonably certain. The Court implicitly held that its judgment in hindsight, not the insurer's judgment at the time, determined whether liability was reasonably certain even prior to suit. Although this case presented compelling facts for this principle — the insured had clearly violated the law requiring working smoke detectors — it may be applied in subsequent cases where liability is less obvious. Second, the duty to settle may exist in the absence of any lawsuit, and therefore before any duty to defend arises.

The Court also rejected Farmers' defense that it never actually received a settlement demand from the claimant, and that such a demand was a prerequisite to any duty to settle. The Court correctly pointed out that Farmers had told the claimant not to submit such a demand, which served essentially as a rejection. However, the Court also opened the door to an ambiguous duty to attempt to settle even in the absence of a demand from the claimant. When combined with a pre-lawsuit duty to settle, this duty would have potentially far-reaching effects.

The Court also attached significance to the fact that Farmers did not communicate to its insured, at any time before suit was filed, that medical bills already exceeded the policy limits or that it had instructed claimant's counsel not to submit a "settlement package." Thus, insurers are well-advised to keep their insured apprised of developments and communications with claimants, even before suit is filed.

Finally, the Court found that Farmers could not "cure" its pre-suit failure to attempt to settle by offering its policy limits in settlement after its insured was sued. This is significant, because all of the acts constituting bad faith took place before the insured was sued. After suit was filed, Farmers behaved as the model insurer by defending and tendering its policy limits. By that time, however, its bad faith claims handling had exposed it to liability far in excess of its policy limits. The inability to "cure" bad faith emphasizes the need for careful handling of every claim from the outset.

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