

# Insurers' Duty to Settle Claims for Voluntary Remediation

BY KENNETH ANSPACH

**I**s an insurer with a duty to settle claims obligated to settle a claim for remediation costs incurred under a state voluntary-cleanup program? Under these circumstances, courts should apply the duty to settle and require the insurer to pay the costs of the voluntary remediation.

The duty to settle requires that the insurance company settle claims in good faith. That duty applies particularly to settlement of environmental claims. Every jurisdiction that affords the right to settle environmental liabilities through the voluntary cleanup of polluted sites affords an opportunity for the application of this duty. Moreover, this duty is extracontractual and applies regardless of whether the insurer has a duty to defend. Thus, it comes to the fore in every situation where a claim is denied due to the absence of a lawsuit. It is an obligation that is little known and little discussed, but which has a scope and import that are nationwide. For purposes of this article, and by way of example, the duty will be examined as it has been applied in Illinois.

Suppose a hypothetical company, Acme Toxic Dump Inc., is being investigated by the Illinois Environmental Protection Agency (EPA) for 10 years of illegal dumping at a Chicago location. Facing huge potential remediation costs (as well as thousands of dollars of potential civil penalties),<sup>1</sup> Acme enrolls itself into the Illinois Site Remediation Program<sup>2</sup> to avoid that liability. Because of cost savings inherent in the Site Remediation Program, the cost of remediation would be slightly lower than Acme's \$1,000,000 of primary coverage and \$5,000,000 of excess coverage. Failing to resolve its liability with the state through the Site Remediation Program would more than double Acme's remediation costs, far exceeding its coverages.

Suppose further that Acme notifies its primary and excess insurers on the risk

during the entire 10-year period of an occurrence and claim, and of its enrollment into the Site Remediation Program, and that none objects to Acme's enrollment. What happens when an insured such as Acme with a contaminated site enters a state program to clean up that site and expends monies for investigation and remediation to avoid even greater environmental liabilities? For example, the Site Remediation Program provides for voluntary cleanup of certain types of sites under the oversight of the Illinois EPA. When an insured enters into such a program and thereby resolves his or her environmental liability to the state, are such costs reimbursable under the insured's primary or excess liability policies as a settlement cost?

## Primary and Excess Policies

The typical primary policy language imposing on the insurer a duty to settle claims appears in the grant of coverage, section I, as follows:

The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of

- A. bodily injury or
- B. property damage

to which this insurance applies, caused by an occurrence, and the company shall have the right and duty to defend any suit against the insured seeking damages on account of such bodily injury or property damage, even if any of the allegations of the suit are groundless, false or fraudulent, *and may make such investigation and settlement of any claim or suit as it deems expedient. . . .* (emphasis added)

Thus, the primary policy dictates that the insurer "may make such investigation and settlement of any claim or suit as it deems expedient."

The typical excess policy language imposing on the insurer a duty to settle claims is found at section II thereof, as follows:

## Investigation, Defense, Settlement

The Company will defend any claim or suit against the **insured** seeking **damages** on account of injury or damage to which this policy applies and which no underlying insurer is obligated to defend, but may make such investigation, defense and settlement thereof as it deems expedient; provided, however, the Company shall have the right but not the duty to investigate, settle or defend any such claim or suit brought against the **insured** outside the United States of America, its territories or possessions or Canada.

If the Company elects not to investigate, settle or defend any claim or suit, the **insured** under the supervision of the Company shall arrange for such investigation and defense thereof as are reasonably necessary, and subject to prior authorization of the Company, shall effect such settlement thereof as the Company and the **insured** deem expedient. (bold in original)

Accordingly, the excess policy obligates the insurer to "defend any claim . . . against the insured seeking damages on account of injury or damage to which this policy applies and which no underlying insurer is obligated to defend." Under these circumstances, the insurer "may make such investigation, defense and settlement thereof as it deems expedient." Further, if the insurer fails to investigate, defend, or settle such claim, the excess policy requires that "the insured under the supervision of [the insurer] shall arrange for such investigation and defense thereof as are reasonably necessary, and subject to prior

authorization of [the insurer], shall effect such settlement thereof as [the insurer] and the insured deem expedient.” In other words, the excess policy requires that the insurer “may settle . . . as it deems expedient” any qualifying claim, but that if the insurer elects not to settle, the insured “shall effect such settlement . . . as [the insurer] and the insured deem expedient.” Here, then, under the excess policy, whether the insurer elects to settle the claim or not, the insurer must either settle “as it deems expedient” or allow the insured to settle the claim in a manner that both insurer and the insured “deem expedient.”

### Duty to Settle

While language granting the insurer the right, either on its own or together with the insured, to settle the claim “as it deems expedient” seems to grant the insurer broad discretion in this area, in fact, the duty is mandatory. The duty to settle arises out of the power afforded to the insurance company under the insurance policy to control the settlement decision.

Typically, the same part of the liability insurance contract that requires the company to defend the suit also gives the company control over the settlement decision. The typical clause at issue in duty-to-settle cases states that the company “may make such investigation and settlement of any claim or suit as it deems expedient” . . . Two other clauses in the contract restrict the insured’s control over the settlement process. The cooperation clause permits the insured to pay amounts in settlement, in the absence of the company’s consent, only at the insured’s own expense; the no-action clause effectively bars the insured from suing the company for indemnification should she negotiate a settlement without the consent of the insurance company. Together, these provisions allocate control over negotiation and settlement to the insurance company.<sup>3</sup>

Thus, the interaction among the duty-to-settle provision, the cooperation clause, and the no-action clause have been interpreted by the courts as allocating

control over negotiation and settlement to the insurer. Elucidation of what is meant by the phrase “may make such investigation and settlement of any claim or suit as it deems expedient” in the context of the control afforded to the insurance company to defend and settle claims and suits is set forth in *Brockstein v. Nationwide Mutual Ins. Co.*, as follows:

IT IS AN OBLIGATION THAT IS LITTLE KNOWN AND LITTLE DISCUSSED, BUT WHICH HAS A SCOPE AND IMPORT THAT ARE NATIONWIDE.

While this broad statement appears to give the insurer unlimited settlement discretion, such is not the case—and for good reason. The policy confers upon the insurer the exclusive right to decide whether to settle or defend, but that decision may affect not only its own interest but also that of the insured. Since the insurer has that exclusive right, it must take responsibility for its exercise. While the insurer has an interest in paying out as little as possible on claims covered by its policies, the insured has an interest in not being exposed to a judgment beyond the policy limit. When these two interests conflict, the company has the unenviable duty of dealing fairly with them both.<sup>4</sup>

Thus, while language granting an insurer authority to settle the claim “as it deems expedient” seems to grant the insurer broad discretion in this area, it does not, and the duty must be exercised fairly.

Perhaps the most cogent explanation of the duty to settle is found in *Iowa Physicians’ Clinic Medical Foundation v. Physicians Insurance Co. of Wisconsin*:

The paradigmatic duty-to-settle case involves three parties: the injured third party; the insured, who is being

sued; and the insurer, who controls the insured’s defense. If the third party sues the insured for an amount above the policy limit and seeks a settlement at the upper limit of the policy, a conflict of interests arises. In this situation, the insurer may be tempted to decline the settlement offer, no matter how good the deal is for

the insured, and go to trial. It makes no difference to the insurer’s bottom line whether the case is settled or the jury awards astronomical damages; in either event it will pay out only the maximum on the policy. And if the case goes to trial, at least there’s a shot that they will win and pay nothing. The insured, on the other hand, calculates the risks of trial differently because he will be stuck paying anything above the policy limit. To combat the temptation to ignore an insured’s interest and to make sure that the intent behind the insurance contract is upheld, Illinois courts have recognized that an insurer has a “duty to act in good faith in responding to settlement offers,” and if that duty is breached the insurer is on the hook for the entire judgment, regardless of the policy limit.<sup>5</sup> (citation omitted)

The duty to settle arises from a duty of good faith implied in the insurance contract. It requires an insurance company to “act in good faith in responding to settlement offers” such that it may be required to accept a settlement demand of payment of policy limits to protect its insured against the risk of an even higher judgment that may be later imposed at

trial. Should the insurer ignore this duty, “the insurer is on the hook for the entire judgment, regardless of the policy limit.”

In Illinois, the cases are legion requiring that the insurer employ good faith in exercising the duty to settle. In construing a policy of liability insurance reserving to the insurance company the right to “make such investigation, negotiation and settlement of any claim or suit as it deems expedient,” the court in the seminal case of *Cernocky v. Indemnity Insurance Company of North America*, held:

IT IS THE *RIGHT* TO CONTROL THAT IS SIGNIFICANT, NOT NECESSARILY HOW THE INSURER CHOOSES TO EXERCISE THAT RIGHT.

We hold it to be the law of Illinois that in investigating, defending, considering questions of settlement, and on the question of appeal, the insurance company must give the interests of the insured equal consideration with its own interests and it must in all respects deal fairly with the insured.<sup>6</sup>

Therefore, the insurer must exercise the duty to settle, giving the interests of the insured equal consideration with its own interests. This good-faith duty to settle applies regardless of whether, as here, the underlying occurrence has resulted in the mere existence of a claim, or whether suit has been brought.<sup>7</sup>

Moreover, the duty to settle is an extracontractual remedy arising out of the dependence of the policyholder upon the insurer to conduct the defense properly. As the Illinois Supreme Court stated in *Cramer v. Insurance Exchange Agency*:

The “duty to settle” arises because the policyholder has relinquished defense of the suit to the insurer. The policyholder depends upon the insurer

to conduct the defense properly. In these cases, the policyholder has no contractual remedy because the policy does not specifically define the liability insurer’s duty when responding to settlement offers. The duty was imposed to deal with the specific problem of claim settlement abuses by liability insurers where the policyholder has no contractual remedy.<sup>8</sup>

Thus, the duty to settle arises in the context of the duty to defend.

Insurers often take the position that the duty to settle *only* applies where the insurer has “assumed control of the defense of the Claim.” That is not so. It is the *right* to control that is significant, not necessarily how the insurer chooses to exercise that right. Contrary to the insurers’ argument, the duty to settle is not dependent upon the insurer actually defending the litigation, but also applies where the insurance company, in exercising its control over the defense, allows the insured to hire its own counsel and merely pays defense costs. Under those circumstances, an insurer would be violating its duty to settle if “it either (a) wrongfully rejects a settlement offer made by the party suing the insured and communicated to the insurer, or (b) wrongfully refuses to make a particular settlement offer when requested to do so by the insured.”<sup>9</sup>

#### **Claim Can Trigger Duty to Settle**

While many of the cases referenced above discuss the duty to settle in the context of a pending lawsuit, the language in both the primary policy and the excess policy is quite specific that such duty

apply also in the event of a claim (i.e., in the absence of a lawsuit). That was the holding in *Haddick v. Valor Insurance*,<sup>10</sup> where the Illinois Supreme Court specifically found that the duty to settle arose *before suit*, at the time the claim is made. In *Haddick*, the decedent was killed in a single-car accident. The administrator demanded settlement from the driver’s insurer. When the insurer failed to settle, the administrator withdrew the demand and sued. The court found the complaint sufficiently established the existence of the insurer’s duty to settle. In that regard, the insurer knew the decedent’s medical expenses exceeded its policy limits and that its insured owned and apparently drove the vehicle. The insurer’s duty to settle, therefore, arose at the time the administrator demanded settlement. Because the insurer failed to offer to settle for the policy limits until almost one year after the settlement demand was withdrawn, the complaint sufficiently alleged a breach of its duty to settle. As the court found:

The duty [to settle in good faith] does not arise at the time the parties enter into the insurance contract, nor does it depend on whether or not a lawsuit has been filed. We conclude that an insurance provider’s duty to settle arises once a third-party claimant has made a demand for settlement of a claim within policy limits and, at the time of the demand, there is a reasonable probability of recovery in excess of policy limits and a reasonable probability of a finding of liability against its insured.<sup>11</sup>

Thus, the duty to settle is not dependent upon the filing of a lawsuit, but applies when a claim is made against the insured. Thus, in the hypothetical scenario involving Acme, the mere existence of a claim for environmental liability could trigger the insurers’ duty to settle.

That result is consistent with cases holding that the duty to indemnify also arises in the event of a mere claim for environmental liability. In *Central Illinois Light Company v. The Home Insurance Company (CILCO)*,<sup>12</sup> the Illinois Supreme Court held that expenditures made by

the insured pursuant to the Illinois Site Remediation Program, to investigate and remediate several contaminated sites, were made in response to a claim of strict liability and that they were made for a remedial purpose. As such, they constituted damages within the meaning of excess policies requiring indemnification for damages on account of bodily injury or property damage. The court found that the pertinent policy language did not require the filing of a lawsuit or an administrative complaint as a precondition to the insurer's duty to indemnify.<sup>13</sup>

It follows from the reasoning in cases applying the duty to settle in the event of a mere claim—such as *Haddick*, and cases such as *CILCO* requiring insurers to indemnify covered claims for environmental liabilities—that an insured in the position of Acme, seeking to resolve its environmental liability and avoid remediation costs that would exceed the limits of its primary and excess coverage, must be covered through the insurer's duty

to settle for the cost of doing so. Under such circumstances, “when a claim has been made against the insured and there is a reasonable probability of recovery in excess of policy limits and a reasonable probability of a finding of liability against the insured”<sup>14</sup> then “[t]he duty of an insurance provider to settle arises.” ♻️

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#### Endnotes

1. See Illinois Environmental Protection Act, 415 Ill. Comp. Stat. 5/42.
2. 415 Ill. Comp. Stat. 5/58 et seq.
3. D. Syverund, *The Duty to Settle*, 76 VA. L. REV. 1113 (1990).
4. 417 F.2d 703, 705 (2d Cir. 1969).
5. 547 F.3d 810, 812 (7th Cir. 2008) (citations omitted).

6. 69 Ill. App. 2d 196, 201–08 (2d Dist. 1966), quoting *Ballard v. Citizens Cas. Co. of N.Y.*, 196 F.2d 96, 102 (7th Cir. 1952).
7. *Haddick v. Valor Ins.*, 198 Ill. 2d 409, 415–17 (2001).
8. 174 Ill. 2d 513, 526 (1996) (citations omitted).
9. Allan D. Windt, *Insurance Claims and Disputes* at 5-38 to 5-40 (5th ed. 2007).
10. 198 Ill. 2d 409 (2001).
11. *Id.* at 417–19 (citations omitted).
12. 213 Ill. 2d 141 (2004).
13. *Id.* at 162. *CILCO*, 213 Ill. 2d at 162. To the same effect, see *Keystone Consol. Indus., Inc. v. Employers Ins. Co. of Wausau*, 456 F.3d 758, 762 (7th Cir. 2006) where the court found that “while a lawsuit may be sufficient to trigger an insurer’s duty to indemnify, it is not a necessary condition under Illinois law.” See also *Sokol & Co. v. Atl. Mut. Ins. Co.*, 430 F.3d 417, 421 (7th Cir. 2005) where in a non-environmental context, the court found that “[t]he two duties of the insurer—defense and indemnification—are distinct; while the duty to indemnify may sometimes nest inside the duty to defend, that will not always be the case.”
14. *Haddick*, 198 Ill. 2d at 417.

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