# The National Forum for Environmental and Toxic Tort Issues

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## Inside:





# U.S. Supreme Court Restricts Private Contribution Claims Under CERCLA

By: Michael F. Aylward
Morrison Mahoney LLP
250 Summer Street, Boston, MA 02210
617-439-7556
maylward@morrisonmahoney.com

In a case with significant implications for the scope of environmental liabilities that insurers may be forced to accept coverage for, the U.S. Supreme Court has significantly constricted the availability of private party claims for contribution under CERCLA. The ruling is of all the more significant in view of the number of private party claims that have been filed in recent years, even as the number of Superfund claims initiated by the federal government has dwindled.

In *Cooper Industries, Inc. v. Aviall Services, Inc.*, No. 02-1192 (U.S. December 13, 2004), Aviall sought contribution against Cooper Industries for the cost of cleaning up four polluted properties in Texas that Cooper had owned and operated before selling them to Aviall in 1991. Years later, Aviall discovered contamination on the properties that was apparently attributable to its own operations and Cooper's actions. Aviall alerted the Texas Natural Resource Conservation Commission to the existence of the problem, but neither the State of Texas nor the federal government took any judicial or administrative steps to require Aviall or any other party to undertake a removal action or any other response measure.

Despite the absence of any legal compulsion, Aviall proceeded to voluntarily clean up these properties under the supervision of the TNRCC and ultimately was able to sell them to a third-party in 1995 (although it remained contractually responsible for future cleanup costs). Aviall sued Cooper under Section 113(F)(1) of the federal Superfund Act (CERCLA), contending that it was entitled to contribution for over $5 million that it had paid to date to clean up the contamination.

As originally enacted in 1980, CERCLA had made no express provision for a private party's right of contribution. An explicit right of contribution was not recognized until 1986, when Congress approved the Superfund Amendments and Reauthorization Act (SARA). As codified in 42 USC Section 9613(F)(1), "any person may seek contribution from any other person who is liable or potentially liable under Section 9607(a) of this title, during or following any civil action under Section 9606 of this title or under Section 9607(a) of this title...."

Aviall sued Cooper in the U.S. District Court for the Northern District of Texas seeking to impose obligations under Section 107(a) of CERCLA as well as a claim for contribution under Section 113(f)(1) as well as miscellaneous state law claims.

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## FETTI's 12th Annual Conference

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# U.S. Supreme Court (Cont.)

The CERCLA claims were later combined. Following motions for summary judgment, however, the U.S. District Court ruled that Aviall could not seek recovery under Section 113(f) because Cooper had not been sued under Section 106 or 107. The federal district court declined to exercise jurisdiction over the state law claims.

These findings were affirmed by a divided panel of the U.S. Court of Appeals for the Fifth Circuit in 2001. See *Cooper Industries, Inc. v. Aviall Services, Inc.*, 263 F.3d 134 (5th Cir. 2001). Relying on the "during or following" language in the first sentence of Section 113(f)(1), the Fifth Circuit held that "a PRP seeking contribution from other PRPs... must have a pending or adjudged Section 106 administrative order or a Section 107(a) cost recovery action against it." 263 F.3d at 145. A dissenting member of the panel argued that the concluding sentence in Section 113(f)(1) which states that "nothing in this subsection shall diminish the right of any person to bring an action for contribution in the absence of a civil action under Section 9606 of this title or Section 9607 of this title" was intended to operate as a saving clause, preserving federal common law rights of contribution that might exist even absent pending proceedings under Section 106 or 107(a).

After a rehearing *en banc*, however, the full Fifth Circuit reversed the three-judge panel and instead adopted the dissenting judge's view that a private party could sue under Section 113(f)(1) to obtain contribution regardless of whether the PRP had previously been sued under Section 106 or 107. *Cooper Industries, Inc. v. Aviall Services, Inc.*, 312 F.3d 677 (2002). Three members of the panel maintained the view of the original majority opinion, however, namely that contribution should not be permitted in the absence of such proceedings.

Earlier this year, the U.S. Supreme Court agreed to accept *certiorari* to resolve this dispute and on December 13, 2004, the court reinstated the U.S. District Court's dismissal by a vote of 7-2.

Writing for the majority, Justice Thomas declared that Aviall had no right of contribution under Section 113(f)(1) because that clause specified that a party may seek contribution during or following any civil action under Section 9606 of this title or under Section 9607(a) of this title. The majority found that "the natural meaning of this sentence is that contribution may only be sought subject to the specified conditions, namely 'during or following' a specified civil action."

The majority rejected Aviall's contention that the term "may" should be read permissibly such that "during or following" a civil action is one but not the exclusive instance in which a party may seek contribution. Rather, the court concluded that the natural meaning of "may" is that it authorizes certain contribution actions and no others. Further, the majority concluded that the "during or following" language would be superfluous if Aviall's interpretation were to be adopted.

The majority concluded that its analysis was consistent with the intent of Congress in enacting Section 113. The court noted that Section 113 only provides express avenues for contribution for claims that are asserted "during or following" specified civil actions under Section 113(f)(1) or after a final settlement of the PRP's claim with the United States pursuant to Section 113(f)(3)(b). Such scenarios would be at odds with any interpretation of the statute that permits contribution claims to be made in cases where no claim is pending and no judgment or settlement has ever occurred, as would be the case with a purely voluntary cleanup.

The Supreme Court did not entirely foreclose Aviall's potential rights of action, however. In particular, the court left open the issue of whether Aviall or similarly situated parties in the future could pursue a cost recovery action under Section 107(a), the very claim that Aviall had earlier dropped in its lawsuit against Cooper Industries. As the Fifth Circuit had not chosen to address this issue, the U.S. Supreme Court indicated that it did not feel that it was appropriate for it to resolve an issue of such consequence without proper consideration and resolution by the courts below.

In fact, numerous federal courts of appeal have already ruled that a private party PRP may not

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# Proper Claim Handling Helps Avoid Exposure Under New York Law For Bad Faith Failure to Settle Within Policy Limits

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By Melicent B. Thompson, Esq.
Litchfield Cavo, LLP
40 Tower Lane, Suite 200, Avon, CT 06001
860-255-5577
thompson@litchfieldcavo.com

Clearly not all claims can be settled. Sometimes, those that can take on a "life of their own," resulting in settlement outside policy limits. In such cases, the settling defendant's carrier potentially faces exposure to a bad faith claim for failure to settle within policy limits. As with most bad faith claims, diligent claim handling has far-reaching benefits in avoiding bad faith exposure, such as thorough documentation of claims assessment, valuation and settlement efforts, and prompt attention to facts and legal strategies that bear directly on the claim's value.

New York courts have been particularly prolific in their written opinions addressing the diligence necessary to successfully defend against a bad faith claim for failure to settle within policy limits under New York law. This article surveys the key New York decisional law involving claims of bad faith for failure to settle within policy limits, and suggests some simple claim handling procedures insurers can adopt to avoid exposure to such claims.

## Standard for Bad Faith Failure to Settle Within Policy Limits Under New York Law

The leading, and most often-cited case in New York regarding bad faith for failure to settle within policy limits is *Pavia v. State Farm Mut. Auto. Ins. Co.*, 82 N.Y. 2d. 445 (N.Y. 1993), in which the New York Court of Appeals established the parameters for such a claim. Most importantly, the Court held that while claims for bad faith for failure to settle within policy limits must be based on conduct amounting to more than ordinary negligence, a plaintiff is not required to show a "sinister motive." *Id. at 453*. Rather, the Court held,

> in order to establish a *prima facie* case of bad faith, the plaintiff must establish that the insurer's conduct constituted a "gross disregard" of an insured's interest – that is, a deliberate or reckless failure to place on equal footing the interests of its insured with its own interests when considering a settlement offer [citations omitted]. In other words, a bad faith plaintiff must establish that the defendant insurer engaged in a pattern of behavior evincing a conscious or knowing indifference to the probability that an insured would be held personally accountable for a large judgment or settlement offer within the policy limits were not accepted.

*Id. at 453-454*; see also *Commerce and Industry Ins. Co. v. North Shore Towers Management, Inc.*, 617 N.Y.S. 2d. 632, 635 (N.Y. Civ. Ct. 1994) (same, citing *Pavia*)

New York courts also have listed particular factors to be considered in determining whether an insurer has acted in bad faith in failing to settle within policy limits. These factors include: (1) plaintiff's likelihood of success on the liability issue in the underlying action, (2) the potential magnitude of damages, and (3) the financial burden each party may be exposed to as a result of a refusal to settle. *Commerce and Industry Ins. Co.*, 617 N.Y.S. 2d at 635-36, citing *Pavia*, 82 N.Y.2d at 454-55. Additionally, the trier of fact may consider: (1) the insurer's failure to properly investigate the claim and any potential defenses thereto, (2) the information available to the insurer at the time the demand for settlement is made, (3) the insurer's failure to inform the insured of a compromise offer, and (4) its failure to provide an opportunity to the insured to contribute toward a settlement offer above the policy limits. *Commerce and Industry at 782; Oppel v. Empire Mut. Ins. Co.*, 517 F. Supp. 1305, 1306 (S.D.N.Y. 1981).

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# RESOLVING ENVIRONMENTAL DISPUTES:
## LITIGATION VS. ALTERNATIVE DISPUTE RESOLUTION

By Cyndy Day-Wilson, Esq.
Best Best & Krieger LLP
402 W. Broadway, 13th Fl., San Diego, CA 92101
619-525-1300
cyndy.day-wilson@bbklaw.com

Most environmental disputes arise because people have different views about what they feel is good policy for the environment. For instance, a city may propose the expansion of its airport, but citizens may oppose it because they fear the noise it will generate. Or, the U.S. Army Corps of Engineers may propose that earthmoving activities associated with draining wetlands be regulated under the Clean Water Act while developers may oppose the proposal as too burdensome and costly. The dispute in each of these cases is a question of policy: Should the airport be expanded? Should the regulation be changed to further protect wetlands or is it too costly to developers? People inevitably disagree about what constitutes proper environmental policy in such cases.

In such environmental controversies, it is not at all obvious who will prevail. So, are environmental disputes best handled by litigation or by alternative dispute resolution? There is no easy answer. Knowing your options before you proceed will help you understand the ins and outs of whatever path you choose.

### Litigating Environmental Disputes

The supposed shortcomings of the litigation process have been a much analyzed topic. For all of its alleged limitations, it does have much to offer.

First, litigation means power. Individuals or small groups can take on big corporations or government agencies and win.

Second, a lawsuit, by its very nature, forces action. One party brings an action and the other party must respond. Further, because litigation proceeds in a highly structured manner, the party bringing the action can often set the agenda for the litigation.

Third, the mere filing of a lawsuit may give the plaintiff leverage it may not otherwise have in front of a legislative body or policymaker. For instance, policymakers often try to make all the parties happy by proposing a “middle of the road” solution. A lawsuit takes the dispute out of the political arena. (This does not mean, however, that a completely groundless action should be filed.)

Fourth, in the initial stages, the cost of litigation is relatively cheap. The costs for the preparation of a complaint coupled with the elements of power and leverage, previously discussed, can make litigation a real bargain.

Fifth, for an environmental advocacy group or even businesses or individuals, litigation is a way of bringing issues into the spotlight and swaying public opinion.

Sixth, because trial judges do not have unlimited discretion in regulatory cases, the scope of judicial review is narrow. Thus, it is often easier to prevail by simply showing that the agency involved in the environmental dispute committed a procedural error rather than a bad policy decision.

Seventh, the decision to litigate a dispute is not irrevocable. The parties can continue to negotiate while a lawsuit is pending.

### Alternative Dispute Resolution

A consensual approach to resolving environmental disputes, whether through mediation or arbitration, offers alternatives which may be preferable, depending upon the particular case, to instituting litigation:

First, the parties involved in the dispute will be the ones responsible for fashioning a resolution. This alternative may be especially attractive when the parties have a better understanding of the environmental issues than the judge who may be assigned to the matter. Second, the final outcome of a mediation or arbitration is more likely to reflect both sides interests than a judicial decree. Third, the mediator or arbitrator can be instrumental in identifying alternatives and helping the parties reach "common ground" and ultimately, a resolution. Fourth, narrow standards of review in administrative law often prevent judges from reaching substantive issues and thus, can substantially restrict the scope of the judge's review. Fifth, the parties involved in the dispute may wish to avoid the spotlight.

Keep in mind, however, that ADR must be a deliberate choice by all parties involved before there is any hope of reaching an agreement. There must be an incentive to negotiate to bring all parties to the table.

Whether you choose litigation or ADR to resolve an environmental dispute, it is important to take the time to analyze your particular situation and identify your goals.

## U.S. Supreme Court (Cont.)

pursue a Section 107(a) action against other PRPs for joint and several liability. See e.g., *United Technologies Corp. v. Browning-Ferris Industries*, 33 F.3d 96 (1st Cir. 1994); *Bedford Affiliates v. Sills,* 156 F.3d 416 (2nd Cir. 1998); *New Castle County v. Haliburton NUS Corp.*, 111 F.3d 1116 (3rd Cir. 1997); *Pneumo Abex Corporation v. High Point, T&D Railroad Co.*, 142 F.3d 769 (4th Cir. 1998); *Centerior Serv. Co. v. Acme Scrap Iron and Metal Corp.*, 153 F.3d 344 (6th Cir. 1998); *Pinal Creek Group v. Newmont Mining Corp.*, 118 F.3d 1298 (9th Cir. 1997); *United States v. Colorado and E.R. Co.*, 50 F.3d 1530 (10th Cir. 1995); and *Redwing Carriers, Inc. v. Saraland Apts.*, 94 F.3d 1489 (11th Cir. 1996). The U.S. Supreme Court has left for another day whether it agrees with this nearly uniform view of the federal courts of appeal, or whether a PRP might pursue a Section 107 cost recovery action for some form of liability other than joint and several or whether there is an implied right to contribution under Section 107. Justice Thomas suggested that such rights of contribution might be implied from "during or following" language just as the court had previously recognized in cases involving similar statutes in the past, but that issue has been left for a future case.

The majority's opinion was criticized by Justices Ginsburg and Stevens in a dissenting opinion that argued that Aviall should be permitted to pursue a claim for contribution or recovery under Section 107(a). Inasmuch as such a right of contribution had been recognized as being implied under Section 107, the dissent argued that such rights of contribution should not be retracted by the legislative enactment of Section 113 and should in fact be protected by the "savings clause" conclusion of Section 113. Accordingly, the dissent argued that the full court should have considered whether Aviall could now pursue a Section 107 claim for relief against Cooper.

The result in *Aviall* is likely to have a significant impact on the burgeoning number of private party claims that property owners have filed in recent years to recover the cost of cleaning up contamination on their own property. Even as insurers have seen many fewer U.S. EPA-generated CERCLA claims against PRPs in recent years, private parties have sought to take advantage of CERCLA to pursue prior owners and other parties that they claim to be responsible for contamination on their properties. *Aviall* seems like to slow this trend.

On the other hand, *Aviall* could prove to be a mixed blessing for insurers that have been obliged to accept coverage for the owner's claims. Apart from the insurance coverage question of whether insureds that undertake such cleanup activities were "legally obligated" to do so, *Aviall* now presents the difficulty that the PRP undertaking this work may be unable to recover contribution, at least under Section 113(f)(1) unless it does so during the course of an administrative proceeding under Section 106 or a cost recovery action under Section 107 or as the result of a final settlement with the federal government.

# Proper Claim Handling (Cont.)

The courts caution however, that in evaluating a bad faith claim, a court cannot re-try the underlying claim, or engage in speculation or prognostication of the outcome of an unfinished trial. Rather, the standard has been described as "whether the insurer had an 'arguably prudent' basis for its assessment of the insured's liability and for its position on settlement." *Commerce and Industry Ins. Co.*, 617 N.Y.S. 2d at 635-36. See also *Peterson v. Allcity Ins. Co.*, 472 F.2d 71, 78 n.11 (bad faith "most readily inferable" where defendant's verdict on liability doubtful, and verdict on damages likely to be well in excess of policy limits).

## Acts or Omissions That Potentially Expose a Carrier

In general, New York courts have allowed bad faith claims where it is clear that there was no viable liability defense, and that the potential damages far exceeded the policy limits. For example, in *Knobloch v. Royal Globe Ins. Co.*, 38 N.Y. 2d. 471 (N.Y. 1976), the Court reversed the Appellate Division's reversal of the jury verdict in favor of the insured on his bad faith claim for failure to settle within limits of an insurance policy. In the underlying action, the insured's passenger sued the insured for injuries the passenger sustained when the car the insured was driving hit a rough spot on the Taconic Parkway and overturned. The insurer's refusal to settle within policy limits prior to trial was based, in part, on its intent to assert a defense of contributory negligence by the plaintiff passenger. Notably, however, at the trial of the bad faith claim, the insurer offered no proof of its own evaluation of the case for settlement purposes, or any outside counsels' or other qualified outsider's assessment of the settlement potential and cost of the case. *Id. at 474-78, 480.*

The Court concluded that on the issue of liability, the jury hearing the bad faith case could have found that a defense of contributory negligence by the passenger was highly problematic, and not viable, and that therefore, there was no issue as to causation. *Id. at 480.* Given this, the Court also held that given the nature and extent of the hospital and medical care the claimant underwent as a result of the accident, the jury was entitled to conclude that, if liability were found, damages would almost certainly far exceed the $10,000 policy limit that the insurer ultimately offered on the eve of trial. *Id.* Thus, the court affirmed the jury's determination of bad faith.

However, New York courts have acknowledged that an insurer is not obligated to accept any settlement offer within policy limits because an insurer has a right to refuse to pay a claim based on both legitimate liability and damages defenses. See, e.g., *New England Ins. Co. v. Healthcare Mut. Ins. Co.*, 295 F. 3d 232 (2d Cir. 2002) (for bad faith claim to survive, plaintiff must show a causal connection between the alleged bad faith and the loss of an actual settlement opportunity, such as clear liability), vacated and remanded in part on other grounds, 352 F.3d 599 (2d Cir. 2003); *U.B. Vehicle Leasing, Inc. v. Atlantic Mut. Ins. Co.*, 2004 U.S. LEXIS 3967 (S.D.N.Y. March 12, 2004) (no bad faith where insurer made increased settlement offers without movement by plaintiffs in settlement discussions, and insurer had legitimate reason for delaying settlement in order to determine key factual issue). Similarly, New York courts also have held that insurers confronted with multiple claims arising out of the same accident are not required to

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accept a package deal within the overall policy limits if, in doing so, the insurer would be overpaying on some of the claims. See, e.g., *Red Cross v. Aetna Cas. and Surety Co.*, 688 N.Y.S. 2d. 817 (N.Y. Sup. Ct. 1999); *Bates v. Merchant's Mut. Ins. Co.*, 277 F. Supp. 308 (N.D.N.Y. 1967).

New York law also focuses on the degree to which an insurer itself engages in settlement discussion prior to trial, and whether it includes the insured in that process. For example, in *Young v. American Cas. Co. of Reading, Pennsylvania*, 416 F.2d. 906 (2d Cir. 1969), the Second Circuit, applying New York law, held that an insurer that receives an offer of settlement in excess of the coverage of its policy acts in bad faith if it fails to make any attempt to engage the injured plaintiff's counsel in settlement discussions that would reduce the demand to within the policy limits. *Id. at 910-11.* The Court rejected the insurer's claim that it could not be liable for bad faith absent proof that a settlement within the policy limits was possible, or alternatively, that the insureds were willing and able to contribute any excess required to effect a settlement beyond the policy limits. Rather, the Court placed the burden squarely on the insurer to "flush out" the settlement potential for the case, and to engage in preliminary settlement negotiations designed either to bring a demand within the policy limits or toward a number higher than the policy limits to which the insured realistically could contribute. *Id. at 911.* See also *Hartford Ins. Co. v. The Methodist Hospital*, 785 F. Supp. 38, 41 (E.D.N.Y. 1992) (denying insurer's motion for summary judgment on basis that plaintiffs never indicated they would accept offer within policy limits; underlying plaintiff's willingness to settle for policy limits is one, but not only way, to show actual opportunity to settle existed and therefore triable issue of fact remained as to whether insurer lost an actual opportunity to settle within the coverage limits by reason of bad faith).

New York courts also are more likely to find bad faith where the insurer's pre-trial settlement efforts, or lack thereof, expose the insured to punitive damages and/or are calculated to force the insured into making a larger contribution toward settlement. For example, in *Ansonia Associates Ltd. Partnership v. Public Serv. Mut. Ins. Co.*, 692 N.Y.S. 2d. 5 (N.Y. Sup.Ct. 1999), the Court affirmed the lower decision denying summary judgment to the defendant insurers on a bad faith failure to settle within policy limits claim because the record before the trial court contained evidence from which a jury might conclude that the insurer ignored the underlying plaintiff's settlement overtures in an effort to force the insured to come up with its own settlement money. Initially, the plaintiff in the underlying action made a settlement demand well within the policy limits, which included a contribution from the plaintiff insured of $375,000. The insurance company's counsel urged it to accept the offer, but the insurer decided not to act on that recommendation. Subsequently, the 10 co-defendants in the case settled out separately. The insurer's counsel urged settlement, a second time, stating that resolving the action and extinguishing any liability of the insured, including possible punitive damages, was the preferred action. However, the insurer again ignored that suggestion.

At a trial on liability, the jury returned a verdict that apportioned fault among all of the original defendants, finding the insured to be 80% liable for the injury and answerable for punitive damages for gross negligence and/or willful misconduct. The insured offered its own funds in an attempt to settle the matter for $500,000 above the amount of the $1 million policy issued by the insurer, but the plaintiffs demanded $2.5 million. Shortly thereafter, the case settled for $1.5 million, the entire amount being paid by the plaintiff/insured because the defendant/insurer refused to make any contribution toward the settlement.

The Court concluded that given these facts, "a trier of fact could certainly conclude that the intransigence of the insurer deprived the plaintiff of a legitimate opportunity to compromise the action within the limits of the available coverage at a point when there remained no doubt as to liability." *Id. at 10, citing* Pavia *at 454.* Notably, the defendant insured did not claim that the amount of the settlement was unreasonable. The Court also noted that the record contained evidence from which a jury might conclude that the insurer's rejection

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# Proper Claim Handling (Cont.)

of all offers to settle the claim against the insured was part of a deliberate strategy to avoid payment on the claim, and leave the insured exposed to punitive damages. The Court characterized this as "maneuvering the insured into unilaterally entering into a settlement to avoid the potential of an award of punitive damages, thereby exhibiting bad faith by using economic duress to deprive the insured of the very insurance coverage for which plaintiff contracted." *Id. at 15.*

## Claim Handling Procedures

Given this New York decisional law, there are several general principles by which carriers may guide their claim handling, which would prevent successful prosecution of a bad faith claim for failure to settle within policy limits.

First, courts look to the degree to which the insurer has taken an active interest and role in pursing settlement during the course of the pre-trial litigation, and an insurer is not shielded from bad faith liability simply because the plaintiff never made a settlement demand. Thus, after making an initial assessment of the case, a carrier and/or its defense counsel should make a preliminary inquiry of plaintiff's counsel regarding plaintiff's settlement position. If the demand is unreasonable, based on the facts known at the time, the carrier is at liberty to continue investigating and defending the matter vigorously.

However, if additional litigation reveals that the insured's liability defense is highly problematic, or unlikely to succeed, New York case law appears to establish that the carrier's settlement efforts will face greater scrutiny. Thus, at this stage, the carrier would be well-served to document, or have its defense counsel document, all settlement-related activity on the file, in order to establish a pattern of continued, good-faith settlement efforts. As noted above, a lack of liability defense does not necessarily obligate the carrier to pay any settlement demand made within policy limits. However, New York courts are more likely to focus on the carrier's settlement efforts after it becomes clear that no viable liability defense exists.

Finally, regular communications with the insured, either through the carrier, or defense counsel, regarding the status of settlement negotiations, and the insured's potential exposure in the event of a judgment above policy limits, go a long way in New York toward insulating an insurer against a claim for bad faith to settle within policy limits. As such, the carrier should incorporate in its defense counsel guidelines a requirement of regular settlement-related communications with the insured, and similarly incorporate that requirement into the carrier's in-house claims handling guides and materials. Additionally, the carrier should notify the insured at the initiation of the suit, and periodically throughout the litigation, that the insured has the opportunity to contribute toward settlement at any time.

In sum, to avoid bad faith for failure to settle within policy limits under New York law, a carrier must give equal consideration to the interests of the insured when contemplating settlement offers. Specific methods to achieve this include: making a preliminary inquiry to ascertain plaintiff's settlement position; recording all settlement-related activity; keeping the insured informed of the status of the case, and the settlement negotiations; and settling cases with no viable defense.