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Bad Faith Principles for Any Claim Department To Avoid

Presenters: Natalie Blind, *Century Insurance Group*
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A fire has occurred at a small home in Anytown, Pennsatucky. The home is owned by Donald Harrow and his sister, Darla Harrow, and is insured by Halfway Insurance Group. Although Donald and Darla own the home jointly, the home is insured in Donald's name only. The homeowner is a firefighter who was across town fighting a fire at the time of the subject home fire.

Mike, an adjuster for Halfway, thinks something is fishy about this fire, and sends in an arson specialist who confirms that an accelerant was used in the fire. Mike has not asked Donald where he was at the time of the fire, but is certain that the claim should be denied. Mike runs a loss report on Donald Harrow which reveals that Donald has had two prior claims in his history which were not disclosed in Donald's insurance application that was completed three years earlier. Darla has no prior claims.

After thinking about this issue for ten months, Mike sends a denial letter to Donald citing the failure to disclose the prior claims on the application. Donald is upset when he receives the letter as this was the first return communication Donald has received from Mike in ten months. When Donald receives the letter, Donald informs Mike that Donald never reviewed the computer application which was completed electronically by the Halfway Insurance Agency agent, Will Steele, and signed electronically by Donald.

Before Will completed the application, Will Steele had run a prior loss report on Donald and had discovered the prior claims, but knew that Halfway would not insure Donald as the primary insured with the prior claims on his application; as a result, Will omitted the prior claims. Halfway policy, however, does not consider claims of what it considers secondary insureds. Halfway's underwriting policy will allow an agent to qualify an individual for coverage and add additional insureds which do not have to go through the underwriting process.

Suit has been filed by Donald and Darla asserting bad faith, fraud and other statutory remedies against Halfway and Will Steele. Ira Battle is an outside attorney hired to represent Halfway,

and Ira has just learned that Mike, the adjuster, has an electronic file in his computer that contains potentially explosive damaging information. Ira has responded to a discovery request and has made no mention of the file, because he has been given instruction from corporate counsel that he can never disclose the file. However, Ira believes that Donald and Darla may now be aware of the existence of the file.

The Underinsured Auto

Three years ago twenty ear old Nick Danger was killed in an automobile accident involving his BMW and a truck owned by Joe's Dirt. The dirt truck, driven by a Joe's Dirt employee, attempted to cross a highway. Nick, traveling westbound on the highway, collided with it. The gas tank exploded and Nick was burned to death. The passengers in the Joe's Dirt truck were also severely burned. Subsequently, Joe's Dirt went out of business leaving no assets.

The report of the investigating police officer revealed the Joe's Dirt truck was severely overloaded, weighing more than one ton over the weight limit. The Joe's Dirt truck failed to yield in crossing the highway and was unable to maneuver quickly because of its size and weight. The officer estimated that Nick was traveling at a speed of between 65 and 75 miles per hour before the collision, and between 45 and 55 miles per hour at impact. At impact, the city truck was blocking both westbound lanes of the highway.

The next day the incident was reported by Ned and Nancy Danger, the parents of Nick, to Halfway Insurance Company, the insurance company insuring the BMW. There is no dispute that a policy issued by Halfway insuring the BMW was in effect at the time of the accident. Underinsured motorist (UIM) coverage under the Halfway policy provided a limit of $50,000.00. It is also undisputed that the liability policy for Joe's Dirt provided coverage up to $25,000.00 per claimant and $50,000.00 per accident. Every Insurance Company is the insurer of Joe's Dirt.

The Dangers retained counsel to represent them, and counsel made demand for payment under the UIM portion of the Halfway policy one month after the accident. According to the Halfway file made by the claims adjuster, no investigation was made into the cause of the accident or the liability limits of Joe's Dirt and no settlement was offered. Instead, the Halfway claims adjuster repeatedly told Ned Danger that Halfway would not offer any UIM settlement until the liability limits of the Every Insurance Company had first been exhausted. The Dangers' attorney, Harry Howe, told the Halfway adjuster that the policy liability limits of Every Insurance Company is $25,000.00, and that in light of the accident, his clients' claim far exceeded this amount. Nevertheless, Halfway refused to make any settlement offer, relying on the policy language that that the liability insurance of the tortfeasor must first be exhausted.

This process continued for over seven months. During this time Howe repeatedly contacted the claims adjuster regarding payment of the UIM claim. During this delay, Halfway did not conduct any investigation into the accident or into the liability limits of Joe's Dirt. One year later Howe informed Halfway that settlement with Joe's Dirt was imminent. Halfway, in reply, wrote Howe that if the Dangers settled with Joe's Dirt and executed releases, Halfway would deny UIM benefits because the insurer's subrogation rights would have been extinguished which violated the terms of the policy. The Dangers then settled with Joe's Dirt for $25,000.00, and signed a full release.[1] Once informed of the settlement, the Halfway claims adjuster closed the claim file without payment. The Halfway adjuster reviewed his training manual written by corporate counsel and found no mention of what to do with his personal notes so he destroyed his personal notes on the case.

The Dangers, through their attorney, again requested payment under the UIM policy. Howe informed the adjuster that the delay in payment was causing stress on Ned Danger who had a heart condition. The Halfway adjuster answered by refusing payment based on the release executed by the Dangers releasing Joe's Dirt. The record reveals a memorandum written by Halfway's claim manager in which he acknowledged the heart condition of Ned Danger and noted that Ned Danger may decide to drop the UIM claim due to his health.

Three months later, the Dangers filed suit, alleging bad-faith denial of payment under the UIM policy.[2] Shortly before the suit was filed, but after the claim had been denied, Halfway began an investigation into the accident. At trial, Halfway alleged the claim was denied not only because of Dangers' settlement with Joe's Dirt but also because of the negligence of Nick Danger, the deceased. No mention of this comparative negligence theory as a basis for denial of the claim appeared in Halfway's file until after the date of the denial.

Halfway retained the services of attorney Michael Moore to defend Halfway. After the lawsuit was filed Halfway's in-house counsel learned that the Halfway adjusters routinely discard adjuster notes when the claim file is closed. Michael Moore has just contacted Halfway's in house counsel to prepare responses to discovery and has asked Halfway's in house counsel if the complete claim file has been produced.

[1] The state in which the accident occurred has no statutory scheme governing settlement with a liability party and corresponding underinsured motorist claims.

[2] The state in which the accident occurred permits a direct cause of action against an insurer for UIM benefits and any remedies are based upon common law.

The Construction Arbitration Gone Bad

In February 2011, the Wilsons contracted with Okay Contractors ("OC") to build their new home in Palm Meadow, Pennsatucky. In August 2012, the Wilsons initiated arbitration proceedings against OC with the American Arbitration Association (AAA), alleging construction defects. The amount recoverable through the arbitration proceeding was limited to $2 million.

OC maintained a comprehensive general liability insurance policy with General Liberty Insurance Company ("GLIC") GLIC. OC tendered defense in the arbitration proceeding to GLIC, which informed OC that it would defend under a reservation of rights. Consequently, GLIC provided OC with assigned defense counsel and simultaneously, through its coverage group, investigated the extent to which the Wilsons' claims against OC were covered or excluded by OC's policy.

OC's policy excluded coverage for OC's work, but provided coverage for work performed for OC by subcontractors. Therefore, to ascertain which of the Wilsons' claims, if any, were covered, GLIC sought to determine which entities performed what work on the Wilsons' home, what construction defects resulted from each entity's work, and the cost to repair each defect. Both OC and the Wilsons cooperated with GLIC's requests for information and documentation, providing all that GLIC requested.

Ultimately, in October 2012, GLIC authorized settlement authority of up to $550,000. The Wilsons offered to settle for $1 million, an amount within the limits of OC's policy. Both OC's assigned defense counsel and OC's private counsel recommended that GLIC accept the Wilsons' offer. A settlement was not reached before arbitration.

By late October 2012, the arbitration hearing had been scheduled, with a start date of January 9, 2013. A few days after scheduling, the parties informed the arbitrator that they had agreed, at OC's request, that any award would be a lump sum award. This deviated from the arbitrator's usual practice of providing a detailed, itemized award. GLIC did not learn of the lump sum award agreement until after the arbitration hearing had begun.

GLIC attempted to participate in the arbitration hearing. However, GLIC did not formally move to intervene and did not ask the arbitrator for permission to attend, as allowed by AAA rules. Instead, GLIC informally requested permission to intervene from OC or, in the alternative, to have a GLIC coverage representative observe. OC denied both requests.

On November 9, 2012, GLIC filed a declaratory judgment action against OC in the local state court. The purpose of the action was to resolve coverage issues regarding which of the Wilsons' claims were covered and which were excluded under OC's policy.

On December 30, 2012, GLIC issued a subpoena *duces tecum* to the arbitrator, scheduling the arbitrator's deposition upon written questions after the arbitration was concluded. In addition to making a comprehensive request for documents, the subpoena sought the arbitrator's thoughts

regarding the arbitration. With the subpoena, GLIC sent the arbitrator an *ex parte* cover letter explaining its coverage issues with OC.

OC and the Wilsons received the subpoena two business days prior to the scheduled start of the arbitration hearing.[3] The Wilsons and both OC's private counsel and assigned counsel promptly demanded that GLIC withdraw the subpoena. Eventually, GLIC struck the subpoena and dismissed its declaratory judgment action.

During the sixth day of the hearing, the parties reached a negotiated settlement and entered into a stipulated settlement agreement. The agreement provided (1) a lump sum arbitration award of one million in favor of the Wilsons against OC and (2) assignment of all OC's insurance coverage and bad faith claims against GLIC to the Wilsons. The award was reduced to judgment.

GLIC subsequently filed a second declaratory judgment action against OC and the Wilsons, seeking to determine what portions of the arbitration award/judgment were payable by GLIC pursuant to OC's policy. GLIC's claim acknowledged that some of the damage claimed against OC is covered by the GLIC policy, but much of it is subject to policy exclusions. The Wilsons (as OC's assignees) then demanded that GLIC pay those amounts which GLIC acknowledges are due under its policy, which they identified as at least GLIC's final settlement authority of $550,000. After GLIC refused, the Wilsons counterclaimed in GLIC's declaratory judgment action, alleging the contract and insurance bad faith claims assigned to them by OC.

Guidelines and Duties

I. Actions Which Trigger Bad Faith

A. The claim representative failed to communicate with the claimant during the claim.

B. The claim representative failed to perform an even-handed investigation.

C. The carrier failed to maintain effective oversight of its files and employees.

D. The carrier failed to institute sufficient policies and procedures in underwriting training for its agents.

E. The carrier failed to train the adjuster on underwriting guidelines when those guidelines are used as a reason to deny a claim.

II. Guidelines To Avoid Bad Faith

A. An adjuster and a supervisor must ensure that adjuster's conduct was reasonable at all times under the facts and circumstances then existing.

[3] OC did not receive the cover letter, which GLIC sent only to the arbitrator. OC first learned of the letter from the arbitrator at the commencement of the hearing.

B. The adjuster must document his actions in the claim file and must not generate other outside documents or electronic files which are not part of the claim file.

C. The insurer must develop witnesses who are able to verify the need for each investigative action at the time it was taken.

D. The agent must have solid witness testimony regarding the agent's understanding of the nature of his job and why he or she performed each task.

E. The insurer must be prepared to illustrate that respect was accorded to the insured at all phases of the investigation.

III. Duty of the Adjuster

A. An adjuster shall acknowledge with reasonable promptness pertinent communications relating to a claim arising under the insurer's policy.

B. An adjuster shall adopt and implement reasonable standards for the prompt investigation of claims arising under the insurer's policies.

C. An adjuster shall attempt in good faith to affect a prompt, fair, and equitable settlement of a claim submitted in which liability has become reasonably clear.

D. An adjuster shall not compel policyholders to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them.

For further research on this topic you may review the following:

Alabama *Code of Ala.1975 § 27-12-24; Ala. Admin. Code r. 482-1-124-.04*;

Alaska *Alaska Stat. §21.36.125, 3 Alaska Admin. Code 26.050*;

Arizona *Ariz. Rev. Stat § 20-461; Ariz. Admin. Code §R20-6-801*;

Arkansas *Ark. Code Ann. §23-66-206;*

California *Cal. Code Regs. tit. 10, §2695, Cal. Ins. Code § 790.03*;

Colorado *Colo. Rev. Stat. §10-3-1104*;

Connecticut *Conn. Gen. Stat. §38a-816*;

Delaware *Del. Code Ann. tit. 18, §2304(16), Del. Admin. Code 18-900-902(1.2.1.4);*

Dist. of Columbia *D.C. Code Ann. §31-2231.17*;

Florida *Fla. Stat. Ann. §626.9541(1)(i)(3)*;

Georgia *Ga. Code Ann. §33-6-33. GA. Code Ann. §33-6-34*;

Hawaii *Haw. Rev. Stat. §431:13-103(a)(11)*;

Idaho *Idaho Code §41-1329*;

Illinois *215 Ill. Comp. Stat. 5/154, Ill. Admin. Code tit. 50, §919.50*;

Indiana *Ind. Code Ann. §27-4-1-4.5*;

Iowa *Iowa Code §507B.4(9)*;

Kansas *Kan. St. Ann. §40-2404(9)*;

Kentucky *Ky. Rev. Stat. Ann §304.12-230, 806 Ky. Admin. Regs. 12:092, §3;*

Louisiana *La. Rev. Stat. Ann. §22:1214(14)*;

Maine *Me. Rev. Stat. Ann. tit. 24-A, §2436-A*;

Maryland *Md. Code Ann., Ins. §27-303;*

Massachusetts *Mass. Gen. Laws. ch. 176D, §3(9)*;

Michigan *Mich. Comp. Laws Ann. § 500.2026, Mich. Comp. Laws Ann. § 500.2006;*

Minnesota *Minn. Stat. §72A.20 (Subd.12); Minn. Stat. §72A.201 (Subd.4)*;

Mississippi *Miss. Code. Ann. § 83-5-35;*

Missouri *Mo. Rev. Stat. §375.1005; Mo. Rev. Stat §375.1007(3); 20 CSR 100-1.030, Mo. Code Regs. Ann. tit. 20, §100-1.040; Mo. Code Regs. Ann. tit. 20, §100-1.050*;

Montana *Mont. Code Ann. §33-18-201(4), Mont. Admin. R. 6.6.1701(1)*;

Nebraska *Neb. Rev. Stat. §44-1540(7)*;

Nevada *Nev. Rev. Stat. §686A.310(n);*

New Hampshire *N.H. Rev. Stat. Ann. §417:4(XV)(a)(11), N.H. Code Admin. R. Ann. Ins 1001.02;*

New Jersey *N. J. Stat. §17:29B-4(9)(d), N.J. Admin. Code tit.11, §2-17.8*;

New Mexico *N.M. Stat. Ann. §59A-16-20*;

New York *11 N.Y. Comp. Codes R. & Regs. tit. 11, §216.6*;

North Carolina *N.C. Gen. Stat. § 58-63-15(11)*;

North Dakota *N.D. Cent. Code, § 26.1-04-03*(9);

Ohio *Ohio Rev. Code Ann. §3901-1-54, Ohio Rev. Code Ann. §3901-1-07;*

Oklahoma *Okla. Stat. tit. 36 §1250.7(A), Okla. Stat. tit. 365, §15-3-7(a)(1)-(2);*

Oregon *Or. Rev. Stat. §746.230(1)(d),* Or. Rev. Stat. *§746.230(1)(e), Or. Admin. R. 836-080-0235;*

Pennsylvania *31 Pa. Code §146.7, Pa. Stat. Ann. tit. 40 §1171.5(a)(10)*;

Rhode Island *R.I. Gen. Laws §27-9.1-3, R.I. Gen. Laws § 27-9.1-4, R.I. Code. R. 02-030-073, §5D;*

South Carolina *S.C. Code Ann. § 38-59-20;*

South Dakota *S.D. Codified Laws §58-33-67(3)*;

Tennessee *Tenn. Code Ann. §56-8-104, Tenn. Code Ann. § 56-8-104*;

Texas *Tex. Ins. Code §542.056, 28 Tex. Admin. Code* §21.203;

Utah *Utah Code Ann. §31A-26-303, Utah Admin. Code R590-190-10*;

Vermont *Vt. Stat. Ann. tit. 8, §4724(9), Vt. Code. R.21-020-008, §6;*

Virginia *14 Va. Admin. Code 5-400-70, 14 Va. Admin. Code 5-400-40(B), Va. Code Ann. §38.2-510;*

Washington *Wash. Admin. Code §284-30-330, Wash. Admin. Code §284-30-380*;

West Virginia *W. Va. Code. St. R. §114-14-6, W. Va. Code §33-11-4*;

Wisconsin *Wis. Admin. Code Ins. §6.11;* and

Wyoming *Wyo. Stat. Ann. §26-13-124.*

IV. Duty of Corporate Counsel

A. A lawyer shall not reveal information relating to the representation of the client. Exceptions such as the prevention of a crime and the commission of a fraud exist.

B. If a lawyer for an organization knows that an officer or employee of the organization is engaged in action or intends to act in a manner related to the representation that is a violation of a legal obligation or a violation of the law that reasonably might be imputed to the organization and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization.

C. Unless the lawyer reasonably believes that it is not in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted, the highest authority that can act on behalf of the organization as determined by applicable law.

American Bar Association Model Rule of Professional Conduct 1.13

V. Duty of Legal Counsel

A. A lawyer shall not make a false statement of fact or law to a tribunal.

B. A lawyer shall not unlawfully obstruct another party's access to evidence or unlawfully alter, destroy, or conceal a document or other material having potential evidentiary value. A lawyer shall not counsel or assist another person to do any such act.

C. A lawyer shall not fail to make a reasonably diligent effort to comply with a legally proper discovery request by an opposing party.

American Bar Association Model Rule of Professional Conduct 3.3 and 3.4.