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By Stating A Cause of Action For Reverse Bad Faith Against The Insured, Does An Insurance Carrier Have A Remedy Against Its Insured For Adversely Affecting Its Ability To Defend A Claim By Acting In Bad Faith

I. Tactics Used by Plaintiff's Attorneys To Create Bad Faith Claims Against The Carrier

Though a Carrier has a duty to place its insured's interests above its own, the national trend around the county is to limit the insurer's right to conduct an investigation to determine if the insured is realistically subject to any personal exposure beyond the policy limit, whether the claim would even reach the policy limits or is defensible as to liability. Often times, a Plaintiff's attorney will take a case, send a policy limit demand and expect the Carrier to respond within seven (7) days. It is not uncommon for some attorneys to even shorten the time frame. In situations like that, the Carrier is put in an tenuous position in having to respond on such short notice. These cases are usually not in suit when these demands are made and it is the Plaintiffs' attorney's intention to force the Carrier's hand from its position of perceived weakness in determining how it must respond and whether its runs the risk of not only exposing the insured, but the Carrier itself, to a large judgment.

Often times, when the Carrier receives a policy limit demand with a short time to reply it has not had a chance to evaluate pertinent information. As a result, the Carrier can find itself in a dangerous area because if it does not respond within the proscribed timeframe, Plaintiffs' attorneys will threaten to recover from the insured personally if the demand is not met.

In order to counter the argument that the Carrier does not have enough information to review the claim, the Plaintiffs' attorneys may "hand-pick" certain records and bills that are most favorable to the Plaintiff and forward those to the Carrier so the Carrier has "enough information" to assess the exposure of the insured. The short time for a response can prevent the Carrier from determining whether the claimant has pre-existing conditions; fully exploring the Plaintiffs' claim history and criminal record; and identifying other relevant factors in evaluating the claim and defending its insured.

This provides numerous problems for the Carrier to evaluate the case. Such tactics act to prevent a full and detailed investigation of a claim. As mentioned above pre-existing medical is relevant to a claim and takes substantial time to examine. Further, the potential criminal background of the Plaintiff and prior litigation history are exactly the type of information whose availability to Carriers that Plaintiff's attorneys seek to prevent. With a handful of medical records and a short time to respond, it makes it virtually impossible for the Carrier to prepare a reasonable evaluation of the case.

Another leverage maneuver utilized by Plaintiff's attorneys in states that allow it, results in Plaintiffs' attorneys negotiating directly with the insured entering into a "sweetheart agreement" where the attorney agrees to collect a judgment only against the Carrier. Certain states allow for Consent Judgments in particular situations that will often contain a "Finding of Facts" section that makes it almost impossible for the Carrier to assert otherwise valid coverage defenses.

For instance, if the Carrier is defending under a reservation of rights, some jurisdictions allow for the insured to negotiate directly with the Plaintiff's attorney. As a result, the Carrier is placed in the precarious position of not being able to determine the presence of coverage, but is also faced with the potential situation of defending an equitable garnishment action at the early stages of a lawsuit.

The Carrier should not be pressured into providing coverage when it is not afforded and has properly asserted a reservation of rights so a coverage determination can be made in an efficient and good faith manner. In some states, the ability to properly assess coverage is thwarted by these consent judgments since they are tantamount to a judicial declaration of coverage, depending on the finding of facts asserted.

Plaintiff's attorneys take the position that it is in the insured's best interests to enter into these arrangements where a "Finding of Facts" and Judgment are entered through a sham trial in which the Plaintiff's attorney agrees not to collect against the insured and the insured acts essentially "takes a fall" for the Plaintiff's attorney in Court. The Plaintiff's attorney then proceeds with an equitable garnishment claim against the Carrier for what is usually a judgment well in excess of the applicable policy limit. The result is the Carrier is estopped from attacking coverage and is forced to pay a sham judgment far in excess of the policy limits. In addition, the insured may also assign all or a portion of its "bad faith claim" to the Plaintiff. Therein lies the potential for the plaintiff and the insured to potentially collect against the Carrier in a situation where coverage may not have even existed.

II. What Is Reverse Bad Faith?

Plaintiffs will continue to make policy limits demands in cases where they may or may not be warranted. It is imperative that any time a policy limits demand is received that it is forwarded to the insured. The insured may ask the Carrier to settle the case within the policy limits, but the Carrier should have the ability in conjunction with the insured, to make that decision by properly evaluating the claim and determine whether defending the

claim is consistent with the insured's best interest. If it is determined that the case should be defended, the insured has an obligation to cooperate in that defense. There are times where the insured does not do so for a number of reasons and the Carrier is severely prejudiced in defending the claim.

Reverse bad faith allows for a cause of action against an insured, granting the insured affirmative relief for a frivolous or bad faith action. Cathryn M. Little, *Fighting Fire with Fire: "Reverse Bad Faith" in First-Party Litigation Involving Arson and Insurance Fraud*, 19 Campbell L. Rev. 43, 44 (1996). This is a potential opportunity for a Carrier to take an aggressive action if a fair and proper insurer-insured relationship is not maintained by the insured. Claims for reverse bad faith will require that the following elements be established:

(1) an insured owes his insurer a duty to act in good faith;
(2) the insured in bad faith acts, or fails to act;
(3) such bad faith act, or failure to act, by the insured interferes with the insurer's adjustment, investigation, defense, or settlement of a claim; and
(4) the insurer is prejudiced by the insured's bad faith conduct.

This was most often proposed in first party litigation cases where the insured has a direct cause of action against the Carrier. Given the prominence of various kinds of bad faith actions in third party actions, the amount of exposure associated with them, and often times, the involvement of the insured in directly or indirectly contributing to this growing trend, there is a movement to also apply this in third party litigation as well.

As one would expect, supporters and detractors exist for this equitable, albeit alternative concept for a legal system that seems to be moving towards a goal of compensation rather than justice. Some of the arguments made regarding the adoption of reverse bad faith as a cause of action include: (1) reverse bad faith is a proper cause of action because there is a "mutual obligation of good faith," (2) the insurer has a right to dispute coverage when a claim is considered fairly debatable; and (3) by recognizing the tort of bad faith in this context, it eliminates the unfair advantage created for the claimant by the insured in a third party action.

How issues are presented in a bad faith claim depends on which acts constitute bad faith by the insured. No one can dispute that in almost every insurance contract there is a mutual obligation to act in good faith. In first party litigation, states have noted that there is an unfair advantage created for the insured. ***Johnson v. Farm Bureau Mutual Insurance Company*, *533 N.W.2d 203 (IA 1995).*** Yet many states are reluctant to allow this kind of action to proceed.

Parties opposed to adopting reverse bad faith argue the following points: (1) It is unnecessary because adequate alternative remedies are available to the insurer through court sanctions. ***Id;*** *(2)* "merely asserting the existence of that contractual relationship "without more" fails to give rise to the "exceptional level required for the imposition of tort liability.") ***In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d 436, 452 (D.V.I. 1999)**; (3) California permits the defense of comparative bad faith, ***California***

***Casualty Gen. Ins. v. Superior Court,* 173 Cal.App.3d 274, 283-84, 218 Cal.Rptr. 817, 822-23 (4 Dist.1985)**, and reasons that a breach of the covenant of good faith and fair dealing is essentially a breach of contract at the most fundamental level and therefore there is no need to recognize another cause of action in the form of reverse bad faith. ***Agric. Ins. Co. v. Superior Court,* 70 Cal. App. 4th 385, 389-90, 82 Cal. Rptr. 2d 594, 595 (1999)**; and (4) the insured does not assume the same obligations undertaken by the insurer when they enter into an insurance contract, therefore they cannot bear the same risk of affirmative tort liability in the face of a breach of a "fiduciary-like obligation." ***Agric. Ins. Co. v. Superior Court,* 70 Cal. App. 4th 385, 390, 82 Cal. Rptr. 2d 594, 596 (1999).**

The landmark Missouri case of ***Johnson v. Allstate Insurance Company,*** is an example of where an insured was directly responsible for the Plaintiff's injury, failed to cooperate effectively in the defense and ultimately received an assignment of a "bad faith claim" in which he retained a portion of the judgment. It is this kind of inequitable relief that has led the call for the Carrier to proceed under a theory of reverse bad faith to even the playing field. Otherwise, both the claimant and the insured could potentially profit from insured's own bad faith.

The failure to act by an insured can often times put a Carrier in a difficult position in defending the insured. Reverse bad faith is essentially stating the insured owes more to the Carrier then just paying a premium. If the law does not hold the insured accountable in the insured-insurer relationship, it can result in a systematic failure. It is only when the parties are both acting in mutual good faith that the insurer-insured relationship can be productive.

The failure of the insured to act, whether it be acknowledgment of service, cooperating with counsel or failing to work with the Carrier in the fact-finding process of the claim can prejudice both the insured and the Carrier, with the Carrier bearing a heavier burden. In prosecuting a reverse bad faith claim, it will be the burden of the Carrier to show that it has been prejudiced sufficiently and how the insured prevented the Carrier from properly defending the claim. Not receiving the insured's cooperation results in the Carrier not putting on an effective defense which results in larger settlements and/or judgments. The insured has a contract with the Carrier and should not be allowed to act in a way detrimental to the insured-insurer relationship, yet not be subject to an appropriate consequence.

III. Does Reverse Bad Faith Impact the Duty Owed To The Insured

Some may argue that a Carrier's obligation to its insured bars an action by the Carrier for the insured's bad faith actions. It is important to note that the Carrier is not initiating the potential adversarial position against the insured, but simply reacting to the insured's failure to uphold its obligations under the insurance contract. The types of damages requested by the Carrier are of interest as well. The Carrier's position would likely be weakened in the eyes of most Courts if the relief sought was punitive in nature. It is hard to find fault with an individual or company seeking relief from being prejudiced as a

result of one of the parties to a contract failing to fulfill the legally agreed-to obligations. As expected, there are supporters on both sides of the issue.

Those who believe that Carrier are entitled to cooperation from their insureds contend that BOTH parties have a mutual obligation of good faith. Many find that this is a proper tool for the Carrier since the system as it is being operated in many jurisdictions provides numerous instances for Plaintiffs to take advantage of nuances in the insurer-insured relationship. Other supporters properly note that potential for reverse bad faith prevents the insured from profiting from its own misconduct. Finally, Carriers are forced to spend an inordinate amount of time and money addressing fraud and/or non-cooperative behavior conducted by their own insured that ultimately increase the costs of premiums on innocent parties who are properly participating in the Insurer-insured partnership.

If the insured fails to comply with obligations under set forth in the insurance contract it could have a catastrophic effect on the Carrier. Many supporters of reverse bad faith argue that a Carrier is not breaching it duty to the insured when the insured initiates the breach because the Carrier is placed at an extreme disadvantage and sustains consequential damages.

The Carrier is not allowed the slightest misstep yet the insured is allowed to go unchecked and can act to the great detriment of the Carrier despite a legal obligation to work together. If the Plaintiff and insured can find creative ways to benefit from by the Carrier by the insured acting in bad faith, fairness dictates that the Carrier have a redress. Perhaps with the effective litigation tool of reverse bad faith, the incentive to work dutiful with the Carrier will result in a more harmonious system that benefits both parties.

Another public policy argument regarding reverse bad faith is that by allowing insured's lack of cooperation to go unchecked, ultimately innocent insureds are the ones to pay the price with higher premiums that will naturally result from these skewed results. This is an example where the act of a few are putting the burden on the many who are properly maintaining a mutually, effective relationship. Holding an insured responsible for its failure to act within the terms of the contract would act as a deterrent to and a benefit for the many insureds who value the relationship when both sides effectively meet their obligations.

There are those that oppose the topic of reverse bad faith. The most common argument is the financial disparity between the Carrier and the insured if the Carrier engages in extensive litigation. The argument would be that if the Carrier is allowed to proceed in a cause of action against the insured, in most cases, the insured would not have the financial resources to effectively defend itself and be at the mercy of the Carrier. It seems unlikely Carriers would run amuck with litigation against the insured if the concepts of reverse bad faith was allowed in most jurisdictions. Above all, both the Carrier and the insured benefit by supporting each other and working in the most effective way to defend a claim. Nevertheless, it makes sense to have a legal mechanism for both parties when that fails to occur as it would only serve to improve the functionality of that relationship.