CLM CLAIMS & LITIGATION MANAGEMENT ALLIANCE™

ADVANCING ETHICS, COOPERATION AND EDUCATION

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Hottest Bad Faith Topics from Around the Country

1. WHEN DOES THE DUTY TO NEGOTIATE ARISE

1. INTRODUCTION

Failing to settle a case within policy limits can have catastrophic effects for both the insured and insurer and recent cases have significantly changed the landscape concerning the duty to settle. The old rule that an insurer only had a duty to respond to a settlement demand within limits is being overhauled by courts that have concluded that a "claimant's interest in settlement" is enough to trigger a duty to initiate settlement discussions while others now seem to require that the carrier initiate settlement discussions when necessary to protect the insured, even when there has not been a formal demand.

As the panel will discuss issues dealing with real world application of these new legal principles, the panel believes that this handout would be most useful by providing a brief summary of the major cases that seem to be currently shaping this area of the law.

a. The *Du* Debacle

There are actually two *Du* decisions, *Du v. Allstate Insurance Company* 681 F.3d 1118 (9th Circuit 2012), which we will refer to as *Du 1*, and *Du v. Allstate Insurance Company* 697 F.3d 753 (9th Circuit 2012), which we will refer to as *Du 2*.

In *Du*, the insured, Kim, was involved in an accident in which the four occupants of the second vehicle sustained injury. Kim's insurance policy had a liability limit of $100,000 for each claim and an aggregate of $300,000 for any one accident. Allstate's subsidiary, Deerbrook, attempted to get medical documentation from one of the injured parties, Du.

Although no settlement demands or offers were made until June 9, 2006 when Du's lawyers submitted a $300,000 global demand for all four plaintiffs for the very first time, Du documented her medical costs in excess of $108,000. The other three claimants had medical costs substantially below that number. Deerbrook's adjuster responded that there was insufficient information about the other three claimants and suggested settling Du's claim separately, an idea which was rejected by counsel. Du filed a personal injury lawsuit against Kim and a verdict in excess of $4.1 million was returned. Kim assigned his bad faith claim to Du.

The court in *Du 1* ultimately found that the carrier did not have a duty to offer its policy limit because Deerbrook did not have proof of the injuries of the other three individuals and paying Du $100,000 could have left Kim unprotected if the remaining three claims exceeded $200,000. The court ultimately found that there was no evidence that Deerbrook should or could have made an earlier offer to Du and therefore supported the trial court's finding in favor of Deerbrook.

The amazing part of *Du 1* is that while holding the carrier did nothing wrong, the court put in very broad language about the carrier's duty to settle. The *Du 1* court goes on to state that the duty to settle requires an insurer to "effectuate settlement when liability is reasonably clear, even in the absence of a settlement demand." The court determines that a conflict exists when there is a significant risk of a judgment in excess of policy limits and there is a reasonable opportunity to settle within those limits. The court finds this is true regardless of whether a settlement demand has been made by the injured party.

The court states that California courts have not directly addressed the question but notes that the Ninth Circuit did in *Gibbs v. State Farm Mutual Insurance Company* 544 F.2d 423 (9th Cir. 1976). As shown below, in the *Reid* discussion, *Gibbs* involved a case in which the insurer failed to conduct negotiations when faced with a clear interest expressed by the injured claimant. Therefore, the *Du 1* court may have mischaracterized *Gibbs*.

Du 1 also stated that California Insurance Code 790.03 (h), which enumerates that an insurer must attempt to effectuate the prompt and fair settlement of claims, mandated its result. However, as shown by the *Reid* decision below, the California Supreme Court has determined that 790.03 does not provide a civil remedy for third party claimants.

Immediately the legal press exploded with criticisms of *Du 1,* faulting the court for getting the issue wrong when its ultimate holding obviated the need to even address the settlement issue. Approximately three months later, the Ninth Circuit filed an amended opinion in *(Du 2)*, and on the issue of whether or not a settlement demand is required, the court now states:

> "We need not resolve these two legal issues because we find that in any event, the district court did not abuse its discretion in ruling there was no factual foundation for Du's proposed instruction. … In sum, there was no evidence that Deerbrook should or could have made an earlier settlement offer to Du. Accordingly, the district judge did not abuse his discretion in finding there was no evidentiary basis for Du's proposed instruction." (See Du at 759.)

All discussion of the legal issues involving when the duty to settle commenced were deleted from the opinion as a result of the uproar that followed.

b. *Reid v. Mercury Insurance Co*., 220 Cal.App. 4th 262 (2013).

Reid is a California Court of Appeal decision which took the position that an insurer does not have a duty to initiate settlement discussion or make an offer of policy limits in the absence of a settlement demand.

The trial court ruled in favor of Mercury Insurance on summary judgment and the claimant appealed alleging that Mercury breached its contract and the covenant of good faith and fair dealing by failing to make a settlement offer when liability in excess of the policy limit was "reasonably clear." Other allegations included that the carrier refused to inform Reid of the applicable policy limits.

The Court of Appeals found that for bad faith liability to attach to an insured's failure to pursue settlement discussions when there is exposure to a judgment beyond policy limits, there must minimally be some evidence that the injured party has communicated to the insurer an interest in settlement or some other circumstance demonstrating the insurer knew that settlement within policy limits could feasibly be negotiated. If there is an absence of such evidence, there would be no "opportunity to settle that an insurer would have ignored.

The Court of Appeals found that there was no settlement offer from plaintiff and no evidence from which any reasonable juror could infer that the defendant knew or should have known that plaintiff was interested in settlement.

The court noted that cases have found that an insurer may be liable for bad faith refusal to settle without a settlement offer, but notes that none of the cases suggests that an insurer has a duty to initiate settlement discussions, or has an opportunity to settle, in the absence of any indication from the injured party that he or she is inclined to settle within the policy limits.

The carrier specifically referred to *Boicourt v. Amex Assurance Co.,* 78 Cal.App. 4th 1390 (2000), in which the carrier had a blanket rule that it would not disclose policy limits to an injured claimant. The *Boicourt* court found that such a blanket policy might foreclose settlement opportunities which could have arisen and did so in an arbitrary manner. Therefore, in that circumstance, an actual demand was not required since an appropriate demand could really not be made.

The *Reid* court stated that the cases on point that did not require an actual demand involved at least circumstances where the claimant had conveyed to the insurer an interest in settlement and the insurer has either rejected or ignored the opportunity to take advantage of that interest to the benefit of its insureds. The court goes on to cite other cases in which there was not a formal settlement demand, but finds that all of the cases involve evidence that the insurer knew of the claimant's interest in settlement and ignored that interest.

For example, statements by the claimant stating it would be willing to settle for policy limits would be a statement that would indicate interest in settlement.

The *Reid* court then refers to the language in *Du 1*, stating the plaintiff in *Du 1* was asserting the same position that plaintiff was making in *Reid*. The court found that the *Du* court did not resolve the plaintiff's claim since the *Du* court agreed with the trial court that there was no evidentiary basis for the instruction. In summarizing, the court stated:

> "In summary, when a claimant offers to settle an excess claim within policy limits, an opportunity to settle exists and a conflict of interest arises, because a divergence exists between the insurers interest in paying less than the policy limits and the insured's interest in avoiding liability beyond the policy limit (cite omitted) and a conflict may also arise, without a formal settlement offer when a claimant clearly conveys to the insurer an interest in discussing settlement but the insurer ignores the opportunity to explore settlement possibilities to the insured's detriment, or when an insurer has an arbitrary rule or engages in other conduct that prevents settlement opportunities from arising." (Cite omitted.)

But, nothing like that happened here. *Reid* at page 278.

c. *Travelers Indemnity of Connecticut v. Art Specialty Insurance Company,* 2013 WL 619 8966 (E.D. Cal. 2013).

This Federal District Court decision seems to try to tread a middle ground between *Du 1* and *Reid.* The court held that "the duty of an insured to effectuate settlement requires more than merely doing nothing while awaiting a formal written settlement demand. The insurer must act in good faith in response to reasonable opportunities to settle." (*Art Specialty,* at page *11).

d. *Jaimes v. Geico General Insurance Company* 534 Fed Appx 860 (11th Circuit 2013).

We all know about Florida and policy limit demands. In *Jaimes*, the court states that under Florida law, the insurer's good faith requirement obligates the insured to advise the insured of settlement opportunities, to advise as to the probable outcome of the litigation, to warn of the possibility of an excess judgment and to advise the insured of any steps he might take to avoid an excess judgment. Geico argued that it was entitled to judgment as a matter of law because the claimants did not make a demand on Geico, but the court cites another decision finding that lack of a formal offer to settle does not preclude a finding of bad faith.

e. *Powell v. Prudential Property & Casualty Insurance Co.* 584 S.2d 12 at 14 (Fla. 3d DCA 1991).

In *Powell*, the court held that an insurer has the duty to initiate settlement negotiations even without a demand when the insured's liability is clear and there is a likelihood of the judgment exceeding the policy limit. The *Powell* decision has been followed in many cases at this point and Florida law therefore does not appear to require a demand for policy limits as a prerequisite to a finding of bad faith.

f. New Jersey

New Jersey law is reflected in *Rova Farms Resort, Inc. v. Investor's Insurance Co.* 65 N.J. 474, 323 A.2d 495, 496 (1974), where the court held an insurer has an affirmative duty to initiate settlement negotiations unless there is no realistic possibility of settlement within the policy limits and the insured will not contribute to a settlement figure above the policy limits ("We, too, hold that an insurer, having contractually restricted the independent negotiating power of its insured, has a positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage").

g. Illinois

Pursuant to *Adduci v. Vigilant Insurance Co.* 98 Illinois App. 3d 472, 475 (1981), it appears that Illinois law does not require an insurance provider to start settlement negotiations on its own. However, this rule has been greatly eroded by the Illinois Supreme Court in *Haddick v. Valor Insurance* 198 Illinois 2d 409 (2001) where an exception to the *Adduci* rule was adopted where "the probability of an adverse finding on liability is great and the amount of probable damages would greatly exceed policy limits."

h. Arizona

In *Acosta v. Phoenix Indemnity Insurance Co.* 214 Ariz. 380 (2007), the court held that an insured's bankruptcy filing did not preclude a claim for bad faith failure to settle when the insurer could have offered to settle the case contingent on receiving approval from the Bankruptcy Court. The insurer attempted to argue that it could not settle because the insured was in bankruptcy but the court disagreed reasoning the insurer could have at least offered to settle with the claimant subject to Bankruptcy Court approval.

i. Texas

In *American Physicians Insurance Exchange v. Garcia* 876 S.W.2d 842, 849 (1994), the Texas Supreme Court observed:

> We recognize that settlement negotiations are adversarial and that reasonable negotiation often involves hard bargaining by both sides. In describing the *Stowers* duty as a duty to make "reasonable attempts to settle," *Ranger*[1] does not alter an insurer's duty to accept reasonable demands within policy limits. Nor does *Ranger* impose any duty on an insurer to accept a settlement demand in excess of policy limits or to make or solicit settlement proposals. In the context of a *Stowers* lawsuit, evidence concerning claims investigation, trial defense, and conduct during settlement negotiations is necessarily subsidiary to the ultimate issue of whether the claimant's demand was reasonable under the circumstances, such that an ordinarily prudent insurer would accept it. *APIE*, 876 S.W.2d at 849.

The Texas Supreme Court went on to observe that it disagreed with any reading of the "no-demand cases that would require insurers rather than claimants to make settlement offers." *Id.* at FN 17.

However, in the case of *Texoma Ag-Products, Inc. v. Hartford Acc. & Indem. Co.*, 755 F.2d 445, 447 (5th Cir. 1985), the Fifth Circuit stated that:

> The duty of care which the insurer owes to its insured may require that a specific offer from the injured third party be accepted and paid, ***or that the insurer initiate settlement discussions or pursue negotiations with the third party, at any stage of the matter, before or after litigation is initiated, in or out of trial***. What the insurer should do depends upon the circumstances of the particular case. The Texas rule is that "[t]he ultimate responsibility of the insurer to the insured is to exercise such care and diligence which an ordinary, prudent person would exercise in the management of his own business." *Id.* (emphasis added).

j. Louisiana

In *Kelly v. State Farm Fire & Casualty Co.,* 169 So.3d 328 (La. 2015), the Louisiana Supreme Court answered certified questions from the Fifth Circuit Court of Appeals. One of the questions presented asked if an insurer could be found liable for a bad faith failure to settle claim under Section 22:1973(A) when the insurer never received a firm settlement offer.

[1] *Ranger County Mut. Ins. Co.*, 723 S.W.2d at 659 (Tex.1987).

The court held that an insurer can be found liable to its insured for a bad faith failure to settle claim under La. R.S. 22:1973(A) in cases where the injured third party does not make a firm settlement offer. More specifically, the court stated: A firm settlement offer is unnecessary for an insured to sustain a cause of action against an insurer for a bad-faith failure-to-settle claim, because the insurer's duties to the insured can be triggered by information other than the mere fact that a third party has made a settlement offer. *Id.* at 330.

k. "Traditional Rule" States

The Idaho Supreme Court determined it would not extend its bad faith cause of action to encompass failures to investigate or failures to initiate settlement negotiations before suit was filed in *Morrell Construction, Inc. v. Home Insurance Co.* 920 F.2d 576 (9th Cir. 1990). Kansas appears to be governed by *Roberts v. Printup* 422 F.3d 1211 (10th Cir. 2005), which refused to rule that there was a "duty to initiate" settlement negotiations, and *Snodgrass v. State Farm Mut.Auto. Ins. Co*., 804 P.2d 1012, 1022 (Kan. Ct. App. 1991), holding that when there are legitimate grounds to deny coverage there is no duty to initiate settlement negotiations even when liability is clear and the injury is severe.

2. BAD FAITH LIABILITY EVEN THOUGH COVERAGE DOES NOT EXIST

A trend has been evolving where courts allow bad faith claims to go forward even where coverage does not exist under the insurance policy. One of the reasons for the trend involves recognition of the scope of the covenant of good faith and fair dealing.

a. Introduction: Covenant of Good Faith and Fair Dealing

In general, courts recognize there is an implied covenant of good faith and fair dealing in every contract "that neither party will do anything which will injure the right of the other to receive the benefits of the agreement." *Comunale v. Traders & General Ins. Co.,* 50 Cal.2d 654, 658, 328 P.2d 198 (1958)).

The California Supreme Court noted that:

> Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." (Rest.2d Contracts, § 205.) This duty has been recognized in the majority of American jurisdictions, the Restatement, and the Uniform Commercial Code. (Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith* *684 1980) 94 Harv.L.Rev. 369). *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 683-84, 765 P.2d 373, 389 (1988)

As the Arizona Supreme Court explained:

> [O]ne of the benefits that flow from the insurance contract is the insured's expectation that his insurance company will not wrongfully deprive him of the very security for which he bargained or expose him to the catastrophe from which he sought protection. Conduct by the insurer which does destroy the security or impair the protection purchased breaches the implied covenant of good faith and fair dealing implied in the contract. This is not to say, of course, that the insurer must pay claims which are not covered, or take any other action

inconsistent the contract. *Rawlings v. Apodaca*, 151 Ariz. 149, 155, 726 P.2d 565, 571 (1986).

b. General Rule Requires Coverage to Exist

As a general rule there can be no claim for bad faith when an insurer has promptly denied a claim that is in fact not covered.

- *O'Malley v. United States Fidelity & Guar. Co.,* 776 F.2d 494, 500 (5th Cir.1985) (noting that no Mississippi case has ever allowed bad faith recovery for the insured without first establishing liability under the policy)
- *Gilbert v. Congress Life Ins. Co.,* 646 So.2d 592, 593 (Ala.1994) (plaintiff bears the burden of proving a breach of contract by the defendant)
- *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338, 341 (Tex. 1995) ("As a general rule there can be no claim for bad faith when an insurer has promptly denied a claim that is in fact not covered").
- *Reuter v. State Farm Mut. Auto. Ins. Co., Inc.,* 469 N.W.2d 250, 253 (Iowa 1991) ("a bad faith failure to pay the insured when the insured event occurs ... may subject the insurer to tort liability")
- *Wittmer v. Jones,* 864 S.W.2d 885, 890 (Ky.1993) (noting that in order to establish a tort action for bad faith the insured must first prove that the insurer was obligated to pay under the policy)
- *Pemberton v. Farmers Ins. Exchange,* 109 Nev. 789, 858 P.2d 380, 382 (1993) ("An insurer fails to act in good faith when it refuses 'without proper cause' to compensate the insured for a loss covered by the policy.")
- *Hackbarth v. Nationwide Mutual Insurance Co.,* 2014 WL 3378695 *11 (W.D. Pa. July 9, 2014) (since there was no insurance coverage, there was no claim for insurance bad faith as a matter of Pennsylvania law).
- *Bartlett v. John Hancock Mut. Life Ins. Co.,* 538 A.2d 997, 1000 (R.I.1988) ("there can be no cause of action for an insurer's bad faith refusal to pay a claim until the insured first establishes that the insurer breached its duty under the contract of insurance")
- Ostrager & Newman, Insurance Coverage Disputes § 12.01 at 503 (7th ed. 1994) ("The determination of whether an insurer acted in bad faith generally requires as a predicate a determination that coverage exists for the loss in question.")
- 15A Rhodes, Couch on Insurance Law 2d § 58:1 at 249 (Rev. ed. 1983) ("As a general rule, there may be no extra-contractual recovery where the insured is not entitled to benefits under the contract of insurance which establishes the duties sought to be sued upon.").

As the Ninth Circuit stated:

> It is clear that if there is no *potential* for coverage and, hence, no duty to defend under the terms of the policy, there can be no action for breach of the implied covenant of good faith and fair dealing because the covenant is based on the contractual relationship between the insured and the insurer. (*Love v. Fire Ins. Exchange, supra,* 221 Cal.App.3d 1136, 1151–1153, 271 Cal.Rptr. 246 (1990). As the *Love* court observed, its "conclusion that a bad faith claim cannot be maintained unless policy benefits are due is in accord with the policy in which the duty of good faith is [firmly] rooted." (*Id.,* at p. 1153, 271 Cal.Rptr. 246.). *Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th 1, 36, 900 P.2d 619, 639 (1995), as modified on denial of reh'g (Oct. 26, 1995).

c. Bad Faith Can Exist in the Absence of Coverage

In the *Stoker* case, the Texas Supreme Court stated:

> We do not exclude, however, the possibility that in denying the claim, the insurer may commit some act, so extreme, that would cause injury independent of the policy claim. *See Aranda,* 748 S.W.2d at 214. Nor should we be understood as retreating from the established principles regarding the duty of an insurer to timely investigate its insureds' claims. *Stoker*, 903 S.W.2d 338, 341 (Tex. 1995); *See Progressive County Mut. Ins. Co. v. Boyd,* 177 S.W.3d 919, 922 (Tex. 2005) ("We have left open the possibility that an insurer's denial of a claim it was not obliged to pay might nevertheless be in bad faith if its conduct was extreme and produced damages unrelated to and independent of the policy claim.").

Even though the Texas Supreme Court recognized the possibility, the Fifth Circuit noted two years ago that "[t]he *Stoker* language has frequently been discussed, but in seventeen years since the decision appeared, no Texas court has yet held that recovery is available for an insurer's extreme act, causing injury independent of the policy claim." *Mid–Continent Cas. Co. v. Eland Energy, Inc.,* 709 F.3d 515, 521–22 (5th Cir.2013); See also, *Burks v. Metro. Lloyds Ins. Co. of Texas*, CIV.A. H-14-591, 2015 WL 4126654, at *5 (S.D. Tex. July 8, 2015).

As the Dallas Court of Appeals recently explained in the case of *Bernstien v. Safeco Ins. Co. of Illinois*, 05-13-01533-CV, 2015 WL 3958282, at *2 (Tex. App.—Dallas June 30, 2015, no. pet. h.):

> In most circumstances, an insured may not prevail on a bad faith claim without first showing that the insurer breached the contract. *Liberty Nat. Fire Ins. Co. v. Akin,* 927 S.W.2d 627, 629 (Tex.1996). There are two exceptions to this rule: (1) the insurer's failure to timely investigate the insured's claim; or (2) the insurer's commission of "some act, so extreme, that would cause injury independent of the policy claim." *Republic Ins. Co. v. Stoker,* 903 S.W.2d 338, 341 (Tex.1995).

d. Cases from Other Jurisdictions

Other cases have recognized that regardless of coverage, an insurer may breach the covenant of good faith in other ways than the wrongful denial of coverage, including, for example, its handling of the claim.

- *HemoCleanse, Inc. v. Philadelphia Indem. Ins. Co.,* 831 N.E.2d 259, 264 n. 2 (Ind.Ct.App.2005) (noting that "an insurer may exhibit bad faith in, for example, its handling of the claim such that even if it engages in a good faith dispute over coverage it may still breach the covenant of good faith and fair dealing.").

- *Monroe Guar. Ins. Co. v. Magwerks Corp.,* 829 N.E.2d 968, 976 (Ind.2005) (Indiana Supreme Court reaffirmed that a good faith dispute concerning insurance coverage cannot provide the basis for a claim in tort that the insurer breached its duty to deal in good faith with its insured" and reiterated that "an insurer's duty to deal in good faith with its insured encompasses more than a bad faith coverage claim." The court acknowledged that the obligation of good faith and fair dealing with respect to the discharge of the insurer's contractual obligation includes the obligation to refrain from (1) making an unfounded refusal to pay policy proceeds; (2) causing an unfounded delay in making payment; (3) deceiving the insured; and (4) exercising any unfair advantage to pressure an insured into a settlement of his claim. The bad faith claim was based on insurer's manner of handling the claim. The court then determined whether, apart from the insurer's denial of the insured's claim based on a good faith dispute over coverage, the insurer's conduct leading up to and including the issuance of the denial letter rose to the level of bad faith.; *see also, Klepper v. ACE Am. Ins. Co.*, 999 N.E.2d 86, 98 (Ind. Ct. App. 2013), reh'g denied (Feb. 19, 2014), transfer denied, 12 N.E.3d 878 (Ind. 2014)

- The general premise for allowing a bad faith action, even in the absence of coverage or breach of contract, is all insurance companies have an implied covenant of "good faith and fair dealing." *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198 (Cal. 1958); *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973).

- An insurer can be liable for the tort of bad faith for certain conduct where it would not be liable for a tortious breach of contract. Adopting the tort of bad faith is consistent with the case law and statutory provisions dealing with insurer misconduct in this jurisdiction. In addition, the special relationship between insurer and insured is, as the *Rawlings* court observed, atypical, and the adhesionary aspects of an insurance contract further justify the availability of a tort recovery. Finally, a bad faith cause of action in tort will provide the necessary compensation to the insured for all damage suffered as a result of insurer misconduct. Without the threat of a tort action, insurance companies have little incentive to promptly pay proceeds rightfully due to their insureds, as they stand to lose very little by delaying payment. *Best Place, Inc. v. Penn America Ins. Co.*, 82 Haw. 120, 920 P.2d 334 (1996).

- It is possible for an insurer to breach the duty of good faith without breaching the insurance contract. *Richardson v. Guardian Life Ins. Co.*, 984 P.2d 615, 624 (Or. App. 1999).

- Court finds nothing in the case law that requires that the tortious conduct be accompanied by a breach of the contract. An action for punitive damages from tortious conduct is not precluded when the company eventually pays, if there is bad faith in the delay and aggravating conduct is present. *Robinson v. North Carolina Farm Bureau Ins. Co.*, 86 N.C. App. 44, 356 S.E.2d 392 (1987)

- The implied covenant is breached whether the carrier pays the claim or not, when its conduct damages the very security which the insured sought to gain by buying insurance. The mere failure to immediately settle what later proves to be a valid claim does not in itself establish bad faith. The insured must show the insurer intentionally and unreasonably denies or delays payment. *Rawlings v. Farmers Ins. Co. of Arizona*, 726 P.2d 565 (Ariz. 1986).

- Court holds that an insurer's liability for coverage and the extent of damages, and not an insurer's liability for breach of contract, must be determined before a bad faith action becomes ripe, clarifying earlier decisions. *Cammarata v. State Farm Florida Ins. Co.*, 152 So. 3d 606, 610 (Fla. Dist. 4th DCA 2014), *reh'g denied* (Jan. 12, 2015), *review denied*, SC15-288, 2015 WL 2330057 (Fla. May 14, 2015).

3. 20-MINUTE MASTERY OF INSTITUTIONAL BAD FAITH

WHAT IS IT?

Systematic unfair claims practices deviating from general practices of good faith and fair dealing, including suppressing claims payments to achieve pre-determined financial goals.

Accomplished by encouraging, rewarding, pressuring tactics of "delay, deny, defend" claims.

Claimant must show "general business practice" and must link harm to the bad company practices.

Policyholder view: Practices to unfairly obtain low-ball settlements to boost underwriting profits.

Insurer view: Necessary procedures to combat fraud and inflated claims, and to control waste and inefficiency to benefit all policyholders and shareholders.

WHAT IS THE PURPOSE OF THE ALLEGATION?

Policyholder view: Expansion of an individual bad faith suit into a far-reaching probe of the insurer's practices and procedures, and to enhance punitive damage claim. By systematically paying less than fair value for claims, the claim department becomes a profit center

Insurer view: Improper attack on the right of every insurer to make an underwriting profit. Excessive and improper claims payments contribute to underwriting losses, and there is nothing wrong with implementing efficient claims adjustment practices.

WHAT CONDUCT MAY BE SCRUTINIZED (AND MISCONSTRUED)?

Claim adjusters' bonuses and performance analysis tied to pre-determined goals for reduction of claims expenses and claims payments.

Roundtables: Destruction of documents?

Computer programs

Claims manuals and protocols

Settlement tactics

EXAMPLES

The McKinsey Documents: Allstate and other insurers embraced a computer-driven method, sold to them by McKinsey & Company, replacing traditional claim adjusting to produce purposefully low offers and average of 30% below market. Eventually, the documents were the subject of fierce litigation seeking discovery.

White v. Continental General Ins. Co., 831 F.Supp. 1545 (D. Wyo. 1993): Rescission of plaintiff's health insurance for failure to reveal history of depression, and refusal to pay for hospitalization for thyroid cyst. Allegations of a general practice of "post-claim underwriting" and a bonus plan awarding adjusters for finding preexisting conditions upon which to deny coverage.

Zilisch v. State Farm, 995 P.2d 276 (Ariz. 2000): Alleged improper refusal to pay $100,000 in underinsured motorist coverage even though knowledge that claim was nearly four times as high. Evidence of nationwide practice of underpayments. Jury verdict for $1 million reversed by Court of Appeals on the ground the claim was "fairly debatable as a matter of law." Arizona Supreme Court reversed and remanded for further proceedings on the ground the Court of Appeals application of the "fairly debatable" defense was too broad.

Merrick v. Paul Revere Life Ins. Co., 594 F.Supp.2d 1168 (D. Nev. 2008): UnumProvident allegedly mistreated a venture capitalist insured under an "own occupation" disability policy. Carrier allegedly targeted subjective claims such as mental and nervous disorders such as chronic fatigue syndrome. Roundtables used of high value claims, but the company policy was to destroy all records of the roundtable, including the identities of the participants, subjects discussed, and reasons for the decision. The court found: "Not only did Plaintiff establish the existence of a corporate scheme to augment profits at the expense of disabled policy holders, [he] establish that his claim was mishandled in a manner consistent with that scheme." *Id.* at 1176. The court did, however, reduced to punitive damage award from $36 million to $26 million to conform to constitutional ratios.

HOW TO PREVENT?

Develop a culture dedicated to resolving each claim promptly and fairly in accordance with good faith and fair dealing, that is, pay a fair amount when liability and damages are reasonably clear.

To accomplish: investigate fully and fairly; evaluate thoroughly retaining judgment along with claims management software; communicate frequently and truthfully; and negotiate where liability is reasonable clear, and avoid low-ball offers. Finally, document actions at each step.