COMPENDIUM OF PRINCIPLES

OF LAW

REGARDING *BAD FAITH*

IN THE FIFTY STATES AND D.C.

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Compiled by the Insurance Coverage and Bad Faith Group
Of the Primerus Defense Institute

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ALABAMA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action?

    - The tort of bad faith was a judicially created and recognized remedy later codified (and largely statutorily ignored) in Ala. Code § 27-12-24 (1975).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - "In the 'normal' bad faith case, the plaintiff must show the absence of *any* reasonably legitimate or arguable reason for denial of a claim. In the 'abnormal' case, bad faith can consist of: (1) intentional or reckless failure to investigate a claim, (2) intentional or reckless failure to properly subject a claim to a cognitive evaluation or review, (3) the manufacture of a debatable reason to deny a claim, or (4) reliance on an ambiguous portion of a policy as a lawful basis for denying a claim." *Singleton v. State Farm Fire & Casualty Company*, 928 So.2d 280, 283 (Ala. 2005); quoting *State Farm Fire & Casualty Co. v. Slade,* 747 So.2d 293 (Ala. 1999).

    - "'Bad faith . . . is not simply bad judgment or negligence. It imports a dishonest purpose and means a breach of known duty, i.e., good faith and fair dealing, through some motive of self-interest or ill will.' " *Slade, 747* So. 2d at 303-04.

    - "When a claim is 'fairly debatable,' the insurer is entitled to debate it, whether the debate concerns a matter of fact or law." *Slade*, 747 So. 2d at 303. "Bad faith is not simply bad judgment or negligence. It imports a dishonest purpose and means a breach of known duty,

i.e., good faith and fair dealing, through some motive of self-interest or ill will." *Singleton*, 928 So. 2d at 283.

- An insurer has an obligation to properly evaluate settlement of a claim within policy limits. "[T]he inquiry relevant to a claim alleging bad faith failure to settle is whether the insurer's failure to settle had any lawful basis, that is, whether the insurer had any "legitimate or arguable reason for failing to pay the claim." *Mutual Assurance, Inc. v. Schulte, M.D.*, 970 So.2d 292 (Ala. 2007); see also *National Sec. Fire & Cas. Co. v. Bowen*, 417 So.2d 179 (Ala. 1982).

- "[A]n actionable tort arises for an insurer's intentional refusal to settle a direct claim where there is either '(1) no lawful basis for the refusal coupled with actual knowledge of that fact or (2) intentional failure to determine whether or not there was any lawful basis for such refusal.'" *Chavers v. National Sec. Fire & Cas. Co.* (Ala. 1981) 405 So.2d 1, 7.

- What are the applicable statutes of limitations?

  - Two years.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - A prerequisite to a successful [normal] bad faith claim is a "covered" claim under the contract of insurance. *White v. State Farm Fire & Cas. Co.*, 953 So.2d 340 (Ala. 2005). Absent contractual liability, no claim for bad faith will lie. Where a disputed question of fact exists, the plaintiff is not entitled to a directed verdict on the contract claims, and bad faith claims should not go to the jury. *Chastain v. Baldwin Mut. Ins. Co.*, 495 So.2d 684 (Ala.Civ.App. 1986).

  - An insurer may plead "advice of counsel" as a defense to a bad faith claim, but it is not an absolute bar to the claim. To avoid liability in the "normal" bad faith context, it must show a "fairly debatable" reason for denial of the claim. It may not rely on an ambiguous provision to deny coverage.

- The plaintiff asserting a bad faith claim is not required to satisfy the "directed-verdict-on-the-contract" claim for an "abnormal" bad faith claim to go to the jury. *White v. State Farm Fire & Cas. Co.*, 953 So.2d 340 (Ala. 2006). However, the jury must decide that there was a covered claim before imposing liability for abnormal bad faith. *Id*.

- What are the recoverable damages for the bad faith cause of action?

  - Compensatory and punitive damages are recoverable in a bad faith cause of action under Alabama law.

  - An insurer can be liable for damages *in excess of limits* in a bad faith failure to settle case. *Waters v. American Casualty Co. of Reading,* PA, 73 So.2d 524 (Ala. 1953).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. All bad faith causes of action carry punitive damages because it has been recognized as a species of fraud. *Chavers v. National Sec. Fire & Cas. Co.*, 405 So.2d 1 (Ala. 1981).

  - Punitive damages are recoverable upon the plaintiff's proof of the bad faith claim because of the burden of proving "intentional" conduct and a "dishonest purpose."

- Are punitive damages insurable?

  - Yes, punitive damages are insurable if not excluded, and the exclusion of punitive damages under certain, limited circumstances violates public policy. This rule applies to exclusion of punitive damages under UM/UIM coverage and wrongful death, which statute carries only punitive damages. *See, e.g., Hill v. Campbell*, 804 So.2d 1107 (Ala. 2001) (on the issue of UM/UIM Coverage); *Campbell v. Williams*, 638 So.2d 804 (Ala. 1994) (on the issue of Wrongful Death). See also, *Ross Neely Systems, Inc. v. Occidental Fire & Cas. Co. of North Carolina* (11th Cir. 1999) 196 F.3d 1347, 1350 (it is not against public policy of Alabama to exclude coverage for punitive damages from an auto policy).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - There is no case directly on this point. However, an insurer can be liable for damages *in excess of limits* in a bad faith failure to settle case. *Waters v. American Casualty Co. of Reading,* PA, 73 So.2d 524 (Ala. 1953). It arguably follows that if an insurer is found liable for bad faith failure to settle (as opposed to negligent failure to settle – Alabama recognizes both), then it refused to settle a claim and exposed its insured to an excess verdict that included counts or damages not covered by the policy when it had an opportunity to settle all claims against its insured within limits (i.e., a violation of the enhanced obligation of good faith and fair dealing). The punitive damages awarded against its insured become the basis for the insured's damages against the insurer, and are likely recoverable against the insurer, since it placed its own financial interests above the insured in contravention of the enhanced duty under *L & S Roofing Supply Co. Inc. v. St. Paul Fire and Marine Insurance Company,* 521 So.2d 1298 (Ala. 1987).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - No. But there is an "enhanced obligation of good faith" insurers and insurer-appointed defense counsel must follow when the defense is being provided under a reservation of rights. *L & S Roofing Supply co. v. St. Paul Fire & Marine Ins. Co.*, 521 So.2d 1298 (Ala. 1987). "The enhanced obligation is fulfilled by meeting specific criteria. First, the company must thoroughly investigate the cause of the insured's accident and the nature and severity of the plaintiff's injuries. Second, it must retain competent defense counsel for the insured. Both retained defense counsel and the insurer must understand that only the insured is the client. Third, the company has the responsibility for fully informing the insured not only of the reservation-of-rights defense itself, but of all developments relevant to his policy coverage and the progress of the lawsuit. Information regarding progress of the lawsuit includes disclosure of all settlement offers made by the company. Finally,

an insurance company must refrain from engaging in any action which would demonstrate a greater concern for the insurer's monetary interest than for the insured's financial risk." *Shelby Steel Fabricators, Inc. v. USF&G*, 569 So.2d 309, 312 (Ala. 1990); quoting *L & S Roofing, supra.*

- Generally, appointed defense counsel should refrain from any conduct that may jeopardize coverage for the insured, such as moving for summary judgment on covered claims to leave non-covered claims remaining in the action.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

  - No. *See, e.g., Lifestar Response of Alabama v. Admiral Insurance Company*, 17 So.3d 200 (Ala. 2009) (Holding that because an attorney is ethically-prohibited from accepting compensation from a third party unless there is no interference in his independent professional judgment, carrier cannot be liable for his malpractice).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action?

  - No. A third party may sue under Alabama's Direct Action Statute, Ala. Code §27-23-2 (1975), but the recovery is limited to the "amount of coverage provided in the policy" and "does not extend to any portion of the original judgment exceeding policy limits." *Dumas Brothers Manufacturing Company, Inc. v. Southern Guaranty Insurance Company*, 431 So.2d 534 (Ala. 1983).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)?

  - No.

ALASKA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? Not without assignment of claim.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. There is no private right of action under Alaska's Unfair Claim Settlement Practices Act. Alaska Stat. 21.36.125(b).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes.

    - *O.K. Lumber Co. Inc. v. Providence Wash. Ins. Co.*, 759 P.2d 523 (Alaska 1988).

        - The fiduciary duty inherent in every insurance contract gives rise to an implied covenant of good faith and fair dealing. *Id.* at 525.

        - An insurer has an obligation to investigate claims and to inform the insured of all settlement offers and the possibility of excess recovery by the injured claimant. *Id.*

    - *State Farm Fire & Cas. Co. v. Nicholson*, 777 P.2d 1152 (Alaska 1989).

        - Breach of the duty of good faith and fair dealing sounds in tort, and is available in both first-party and third-party insurance contexts. *Id.* at 1157.

- *Alaska Pac. Assur. Co. v. Collins*, 794 P.2d 936 (Alaska 1990).
    - Mere negligence by the insurer in denying coverage is not enough to support a tort claim for breach of the implied covenant of good faith and fair dealing.
- *Ennen v. Integon Indemnity Corp.*, 268 P.3d 277 (Alaska 2012).
    - An additional insured is also entitled to bring action for bad faith.

- What are the applicable statutes of limitations?
    - Tort actions must be brought within two years. Alaska Stat. 09.10.070.
    - Actions on contracts must be brought within three years. Alaska Stat. 09.10.053.

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?
    - A bad faith claim will not lie where there is found to be no coverage. *See Makaranka v. Great American Ins. Co.*, 14 P.3d 964, 969 (Alaska 2000).
    - Mere negligence by the insurer in denying coverage is not enough to support a tort claim for breach of the implied covenant of good faith and fair dealing. *Alaska Pac. Assur. Co. v. Collins*, 794 P.2d 936 (Alaska 1990).
    - A claim for bad faith failure to settle does not arise when insurer rejects offer to settle for amounts that exceed policy limits. *Whitney v. State Farm Mut. Auto. Ins. Co.*, 258 P.3d 113 (Alaska 2011).

- What are the recoverable damages for the bad faith cause of action?

- Consequential damages and punitive damages may be available for a bad faith claim. *State Farm Fire & Cas. Co. v. Nicholson*, 777 P.2d 1152 (Alaska 1989).

- Alaska Rule of Civil Procedure 82(a) provides attorney fees to the prevailing party in a civil case.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Punitive damages are available on a showing of clear and convincing evidence that the party's conduct was outrageous, or evidenced reckless indifference to the interests of another. *Great Divide ins. Co. v. Carpenter*, 79 P.3d 599, 608 (Alaska, 2004).

  - "To support punitive damages, the wrongdoer's conduct must be 'outrageous, such as acts done with malice or bad motives or reckless indifference to the interests of another.'" *State Farm Fire & Cas. Co. v. Nicholson*, 777 P.2d 1152, 1158 (Alaska 1989).

  - Punitive damages may be recovered for bad faith failure to settle on a showing of clear and convincing evidence of "outrageous" conduct by the insurer in refusing to settle with its insured. *State Farm Mut. Auto Ins. Co. v. Weiford*, 831 P.2d 1264 (Alaska 1992).

- Are punitive damages insurable?

  - Yes. See *Providence Washington Ins. Co. v. City of Valdez*, 684 P.2d 861 (Alaska 1984) (coverage for punitive damages allowed for a municipal corporation, though court recognized there might be a public policy against insuring punitive damages generally); *State Farm Mut. Auto. Ins. Co. v. Lawrence* (Alaska 2001) 26 P.3d 1074 (UM/UIM coverage that does not specifically exclude punitive damages covers them); *LeDoux v. Continental Ins. Co., Inc*. 666 F.Supp. 178 (D.Alaska,1987); *Aetna Cas. & Surety Co. v. Marion Equipment Co.*, 894 P.2d 664, 671 (Alaska 1995).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

- No decision directly on point. However, answer is likely yes. See *Guin v Ha* 591 P. 2d 1281, holding prejudgment interest was payable in addition to the applicable policy limit if an insurer breaches implied covenant of good faith.

- A claim for breach of good faith duty to settle arises in tort, thus the insured may recover all damages available under tort law. *Alaska Pacific Assurance Co. v. Collins*, 794 P.2d 936 (1990).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - Alaska Stat. 21.89.100 provides:

    (a) If an insurer has a duty to defend an insured under a policy of insurance and a conflict of interest arises that imposes a duty on the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to the insured unless the insured in writing waives the right to independent counsel. An insurance policy may contain a provision that provides a method of selecting independent counsel if the provision complies with this section.

    (b) For purposes of this section, the following do not constitute a conflict of interest:

    (1) a claim of punitive damages;

    (2) a claim of damages in excess of the policy limits;

    (3) claims or facts in a civil action for which the insurer denies coverage.

    (c) Notwithstanding (b) of this section, if the insurer reserves the insurer's rights on an issue for which coverage is denied, the insurer shall provide independent counsel to the insured as provided under (a) of this section.

    (d) If the insured selects independent counsel at the insurer's expense, the insurer may require that the independent counsel have at

least four years of experience in civil litigation, including defense experience in the general subject area at issue in the civil action, and malpractice insurance. Unless otherwise provided in the insurance policy, the obligation of the insurer to pay the fee charged by the independent counsel is limited to the rate that is actually paid by the insurer to an attorney in the ordinary course of business in the defense of a similar civil action in the community in which the claim arose or is being defended. In providing independent counsel, the insurer is not responsible for the fees and costs of defending an allegation for which coverage is properly denied and shall be responsible only for the fees and costs to defend those allegations for which the insurer either reserves its position as to coverage or accepts coverage. The independent counsel shall keep detailed records allocating fees and costs accordingly. A dispute between the insurer and insured regarding attorney fees that is not resolved by the insurance policy or this section shall be resolved by arbitration under AS 09.43.

(e) If the insured selects independent counsel at the insurer's expense, the independent counsel and the insured shall consult with the insurer on all matters relating to the civil action and shall disclose to the insurer in a timely manner all information relevant to the civil action, except information that is privileged and relevant to disputed coverage. A claim of privilege is subject to review in the appropriate court. Information disclosed by the independent counsel or the insured does not waive another party's right to assert privilege.

(f) An insured may waive the right to select independent counsel by signing a statement that reads substantially as follows:

> *I have been advised of my right to select independent counsel to represent me in this lawsuit and of my right under state law to have all reasonable expenses of an independent counsel paid by my insurer. I have also been advised that the Alaska Supreme Court has ruled that when an insurer defends an insured under a reservation of rights provision in an insurance policy, there are various conflicts of interest that arise between an insurer and an insured. I have considered this matter fully and at this time I am waiving my right to select independent counsel. I have authorized my insurer to select a defense counsel to represent me in this lawsuit.*

(g) If an insured selects independent counsel under this section, both the counsel representing the insurer and independent counsel representing the insured shall be allowed to participate in all aspects of the civil action. Counsel for the insurer and insured shall cooperate fully in exchanging information that is consistent with ethical and legal obligations to the insured. Nothing in this section relieves the insured of the duty to cooperate fully with the insurer as required by the terms of the insurance policy.

(h) When an insured is represented by independent counsel, the insurer may settle directly with the plaintiff if the settlement includes all claims based upon the allegations for which the insurer previously reserved its position as to coverage or accepted coverage, regardless of whether the settlement extinguishes all claims against the insured.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Yes. *Continental Ins. Co. v. Bayless and Roberts, Inc.,* 608 P.2d 281 (Alaska 1980). The insurer is liable for any negligence of its agents, including attorneys, in carrying out the duty to defend.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. There is no private right of action under Alaska's Unfair Claim Settlement Practices Act. Alaska Stat. 21.36.125(b).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. Absent an assignment, a third party claimant has no cause of action against a tortfeasor's insurer. *Severson v. Severson's Estate*, 627 P.2d 649, 651 (1981).

ARIZONA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.
- Can third parties sue for bad faith (i.e., third party bad faith)? No, not without an assignment.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.
    - No. The Unfair Claims Practices Act, A.R.S. § 20-461, states, "Nothing contained in this section is intended to provide any private right or cause of action to or on behalf of any insured or uninsured resident or nonresident of this state. It is, however, the specific intent of this section to provide solely an administrative remedy to the director for any violation of this section or rule related to this section." A.R.S. § 20-461(D).
- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.
    - Yes.
    - *Noble v. National Am. Life Ins. Co.*, 128 Ariz. 188, 624 P.2d 866 (Ariz. 1981).
        - "[T]here is a legal duty implied in an insurance contract that the insurance company must act in good faith in dealing with its insured on a claim, and a violation of that duty of good faith is a tort." *Id.* at 190.
        - "The tort of bad faith arises when the insurance company intentionally denies, fails to process or pay a claim without a reasonable basis for such action." *Id.*
        - The tort of bad faith is an intentional tort. To prove bad faith, "a plaintiff must show the absence of a reasonable

basis for denying benefits of the policy, and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim." *Id.*

- *Zilisch v. State Farm Mut. Auto Ins. Co.*, 196 Ariz. 234, 995 P.2d 276 (Ariz. 2000).
    - "The appropriate inquiry is whether there is sufficient evidence from which reasonable jurors could conclude that in the investigation, evaluation, and processing of the claim, the insurer acted unreasonably and either knew or was conscious of the fact that its conduct was unreasonable." *Id.* at 238.
    - Thus, if an insurer acts unreasonably in the manner in which it processes a claim, it will be held liable for bad faith "without regard to its ultimate merits." *Id*. quoting from [*Deese v. State Farm Mut. Auto. Ins. Co.*, 172 Ariz. 504, 509, 838 P.2d 1265, 1270 (1992)].
- *James River Ins. Co. v. Hebert Schenk, P.C.*, 523 F.3d 915 (9th Cir. 2008).
    - "The insurer may commit bad faith not only by intentionally and unreasonably denying a claim, but also by intentionally processing, evaluating, or paying a claim in an unreasonable manner." *Id.* at 923.
- *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 164 Ariz. 256, 792 P.2d 719 (Ariz. 1990).
    - Under a liability policy, "the duty of good faith and fair dealing requires that an insurer give 'equal consideration' to the interests of its insured in deciding whether to accept an offer of settlement." *Id.* at 259.

- What are the applicable statutes of limitations?
    - Two years. Period of limitation begins to run the cause of action accrues. *Ness v. Western Security*, 174 Ariz. 497, 500, 851 P.2d 122 (Ariz. App. 1992)

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - An insurer may challenge claims that are fairly debatable. *Zilisch v. State Farm Mut. Auto Ins. Co.*, 196 Ariz. 234, 237, 995 P.2d 276 (Ariz. 2000).

    - "Mere negligence or inadvertence is not sufficient -- the insurer must intend the act or omission and must form that intent without reasonable or fairly debatable grounds." *Rawlings v. Apodaca*, 151 Ariz. 149, 160, 726 P.2d 565 (Ariz. 1986).

    - When an insurer asserts it is not in bad faith based upon its subjective evaluation and understanding of its personnel about the state of the law, it affirmatively injects legal knowledge of its personnel into the litigation and therefore impliedly waives the attorney-client privilege between itself and counsel, even if the insurer does not assert advice of counsel as a defense. *State Farm Mut. Auto Ins. Co. v. Lee*, 199 Ariz. 52, 65, 13 P.3d 1169, 1182 (2000).

- What are the recoverable damages for the bad faith cause of action?

    - When tort damages are recoverable, "plaintiff is not limited to the economic damages within the contemplation of the parties at the time the contract was made. Plaintiff may recover all the losses caused by defendant's conduct, including damages for pain, humiliation and inconvenience, as well as for pecuniary losses." *Rawlings v. Apodaca*, 151 Ariz. 149, 161, 726 P.2d 565 (Ariz. 1986).

    - "To recover damages for emotional distress caused by an insurer's bad faith, the insured must demonstrate that the insurer's bad faith resulted in an invasion of property rights." *Filasky v. Preferred Risk Mut. Ins. Co.*, 152 Ariz. 591, 597, 734 P.2d 76 (Ariz. 1987).

    - Attorney fees are recoverable in bad faith actions, which are actions that arise out of a contract within the meaning of A.R.S. § 12-341.01, Arizona statute granting court discretion to award attorney fees in actions arising out of contract. *Sparks v. Republic Nat'l Life Ins. Co.*, 132 Ariz. 529, 543, 647 P.2d 1127 (Ariz. 1982).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

- Yes. "[T]to obtain punitive damages, plaintiff must prove that defendant's evil hand was guided by an evil mind." An evil mind is present (1)"where defendant intended to injure the plaintiff." And (2) "where, although not intending to cause injury, defendant consciously pursued a course of conduct knowing that it created a substantial risk of significant harm to others." *Rawlings v. Apodaca*, 151 Ariz. 149, 162, 726 P.2d 565 (Ariz. 1986).

- The required elements must be proven by clear and convincing evidence. *Bradshaw v. State Farm Mut. Auto. Ins. Co.*, 157 Ariz. 411, 423, 758 P.2d 1313 (Ariz. 1988).

- Are punitive damages insurable?

  - Punitive Damages are insurable. See *Price v. Hartford Accident & Indemnity Co.*, 108 Ariz. 485, 502 P.2d 522 (App. 1986).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - There is no case on point. An insurer is free to litigate its coverage defenses after the liability action against the insured is resolved. See *Munzer v Feola*, 195 Ariz. 131, 135, 985 P.2d 616, 620 (App 1999) Insurance company "free to litigate the coverage defense."; see also *MT Builders v. Fisher Roofing, Inc.*, 219 Ariz. 297, 308, 197 P.3d 758, 769 (App. 2008)(In a non-insurance assignment case, Court held that failure to accept defense "did not bar it from contesting its own fault and whether it was under an obligation to indemnify and hold harmless MT Builders harmless from the loss it sustained when it settled the Association's Fisher-based claims."). An uncovered claim would not become covered through a verdict against the insured. However, if the insurer is ultimately found to have acted in bad faith in refusing to settle, the fact that punitive damages are insurable in Arizona might lead a court to conclude that punitive damages assessed against the insured can be recovered as part of the damages for bad faith failure to settle.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - When a conflict between insurer and insured actually arises, "the lawyer's duty is exclusively owed to the insured and not the insurer." *Paradigm Ins. Co. v. Langerman Law Offices, P.A.*, 200 Ariz. 146, 150, 24 P.3d 593 (Ariz. 2001).

    - "[T]he attorney who represents the insured owes him an undeviating allegiance whether compensated by the insurer or the insured and cannot act as an agent of the insurance company by supplying information detrimental to the insured." *Farmers Ins. Co. v. Vagnozzi*, 138 Ariz. 443, 448, 675 P.2d 703 (Ariz. 1983).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Probably not. In addition, malpractice claims cannot be assigned by client/insured to third party claimant. See *Botma v. Huser,* 202 Ariz. 14, 39 P.3d 538 (App. 2002).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. The Unfair Claims Practices Act, A.R.S. § 20-461, states, "Nothing contained in this section is intended to provide any private right or cause of action to or on behalf of any insured or uninsured resident or nonresident of this state. It is, however, the specific intent of this section to provide solely an administrative remedy to the director for any violation of this section or rule related to this section." A.R.S. § 20-461(D).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- No. "The duty to settle is intended to benefit the insured, not the injured claimant." *Page v. Allstate Ins. Co*., 126 Ariz. 258, 259, 614 P.2d 339 (Ariz. App. 1980).

- However, an insured may assign its breach of contract and bad faith claims to a third party, who then stands in the shoes of the insured. *Manterola v. Farmers Ins. Exch*., 200 Ariz. 572, 578, 30 P.3d 639 (Ariz. App. 2001).

- What are the applicable statutes of limitations?

  - Two years. *Manterola v. Farmers Ins. Exch*., 200 Ariz. 572, 576 (Ariz. App. 2001) (applying A.R.S § 12-542).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Because "the third-party's rights or claims derive from and are entirely dependent on the rights and claims of the insured/assignor," the same defenses applicable to claims by the insured will apply. *Manterola v. Farmers Ins. Exch*., 200 Ariz. 572, 578 (Ariz. App. 2001).

- What are the recoverable damages for the bad faith cause of action?

  - The assignee stands in the shoes of the insured, and may recover the damages the insured would be entitled to. *Manterola v. Farmers Ins. Exch*., 200 Ariz. 572, 578 (Ariz. App. 2001).

  - However, "The third party's claim is in reality the insured's claim, but the third party cannot recover damages personally suffered by the insured such as pain and suffering, embarrassment, mental anguish and humiliation. The assignee can only recover the insured's pecuniary losses." *Clearwater v. State Farm Mut. Auto. Ins. Co*., 161 Ariz. 590, 594, 780 P.2d 423 (Ariz. App. 1989) (reversed on other grounds, *Clearwater v. State Farm Mut. Auto Ins. Co.*, 164 Ariz. 256, 792 P.2d 719 (Ariz. 1990)).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

- Yes. "The third party's claim is in reality the insured's claim, but the third party cannot recover damages personally suffered by the insured such as pain and suffering, embarrassment, mental anguish and humiliation. The assignee can only recover the insured's pecuniary losses. If the pecuniary damages (the excess judgment) are the result of conduct entitling a party to punitive damages, we find nothing in the law or public policy prohibiting a third party from asserting that claim." *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 161 Ariz. 590, 594, 780 P.2d 423 (Ariz. App. 1989) (reversed on other grounds, *Clearwater v. State Farm Mut. Auto Ins. Co.*, 164 Ariz. 256, 792 P.2d 719 (Ariz. 1990)).

ARKANSAS

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. However, A.C.A. § 23-79-208(a)(1) provides for a limited private cause of action where an insurer fails to pay a loss within the time specified in the policy after demand is made, and provides that the insurer "shall be liable to pay the holder of the policy or his or her assigns, in addition to the amount of the loss, twelve percent (12 percent) damages upon the amount of the loss, together with all reasonable attorney's fees for the prosecution and collection of the loss." An insurer will be liable under the statute even if the insurer denied coverage in good faith. *See, e.g.*, *Home Mut. Fire Ins. Co. v. Jones*, 63 Ark. App. 221, 977 S.W.2d 12 (1998). The statutory penalties will not be assessed if it was reasonably necessary for the insurer to continue its investigation beyond the time that payment was due. *Silvey Co. v. Riley*, 318 Ark. 788, 790, 888 S.W.2d 636, 638 (1994). Otherwise, the Arkansas Unfair Trade Practices Act, A.C.A. § 23-66-201 et seq., does not provide a private cause of action for violation of its terms.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- Yes. *See, e.g.*, *Findley v. Time Ins. Co.*, 264 Ark. 647, 573 S.W.2d 908 (1978) (recognizing the possibility of a "bad faith" cause of action against insurance companies); *Aetna Cas. & Sur. Co. v. Broadway Arms Corp.*, 281 Ark. 128, 664 S.W.2d 463 (1984) (recognizing bad faith claim for failure to pay policy benefits); *McCall v. Southern Farm Bureau Cas. Ins. Co.*, 255 Ark. 401, 501 S.W.2d 223 (1973) (recognizing there can be a bad faith claim for failure to settle a third-party claim under liability policy).

- According to the Arkansas Supreme Court:

  > [B]ad faith must include affirmative misconduct by the insurance company, without a good faith defense, and that the misconduct must be dishonest, malicious, or oppressive in an attempt to avoid its liability under an insurance policy. Such a claim cannot be based upon good faith denial, offers to compromise a claim or for other honest errors of judgment by the insurer. Neither can this type claim be based upon negligence or bad judgment so long as the insurer is acting in good faith.
  >
  > *Aetna Cas. & Sur. Co.*, 281 Ark. at 133-34, 664 S.W.2d at 465.

- What are the applicable statutes of limitations?

  - Three years. A.C.A. § 16-56-105; see also *First Pyramid Life Ins. Co. v. Stoltz*, 311 Ark. 313, 843 S.W.2d 842 (1992) (applying three-year period to bar first party claim of bad faith against insurer).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Bad faith cannot be asserted on a denial of liability, an offer to compromise a claim, or an error of judgment when such acts are grounded in good faith. *Aetna Cas. & Sur. Co.*, 281 Ark. 128, 664 S.W.2d 463; see also *Parker v. S. Farm Bureau Cas. Ins. Co.*, 326 Ark. 1073, 935 S.W.2d 556 (1996); *Reynolds v. Shelter Mut. Ins. Co.*, 313 Ark. 145, 852 S.W.2d 799 (1993); *Richison v. Boatmen's Ark., Inc.*, 64

Ark. App. 271, 981 S.W.2d 112 (1998); *S. Pine Helicopters, Inc. v. Phoenix Aviation Managers, Inc.*, 320 F.3d 838 (8th Cir. 2003).

- Mere refusal by the insurer to pay a claim when a valid controversy exists concerning liability does not support a bad faith claim. *Stevenson v. Union Standard Ins. Co.*, 294 Ark. 651, 746 S.W.2d 39 (1988); *Cato v. Ark. Mun. League Mun. Health Ben. Fund*, 285 Ark. 419, 688 S.W.2d 720 (1985); *Baker v. Safeco Ins. Co. of Am.*, 175 F.3d 618 (8th Cir.1999).

- Even if a controversy over the existence of a claim is the result of negligence or gross ignorance by the insurer, bad faith is not present. *First Marine Ins. Co. v. Booth*, 317 Ark. 91, 876 S.W.2d 255 (1994).

- Nor does confusion, delay in paying claims, or bureaucratic red tape demonstrate malice or constitute bad faith. *Switzer v. Shelter Mut. Ins. Co.*, 362 Ark. 419, 208 S.W.3d 792 (2005); *Unum Life Ins. Co. of Am. v. Edwards*, 362 Ark. 624, 210 S.W.3d 84 (2005); *State Auto Prop. &Cas. Ins. Co. v. Swaim*, 338 Ark. 49, 991 S.W.2d 555 (1999); *Am. Health Care Providers, Inc. v. O'Brien*, 318 Ark. 438, 886 S.W.2d 588 (1994).

- Some justices have indicated that the insurer's conduct must be "outrageous." *See Employers Equitable Life Ins. Co. v. Williams*, 282 Ark. 29, 34, 665 S.W.2d 873, 876 (1984) (concurring opinion by Hickman, J.).

- What are the recoverable damages for the bad faith cause of action?

  - Compensatory and punitive damages. *Employers Equitable Life Ins. Co.*, 282 Ark. 29, 665 S.W.2d 873.

  - Additionally, A.C.A. § 23-79-208(a)(1), discussed above, also provides for a 12% penalty and attorney's fees. This statutory

remedy does not preempt, but is in addition to, the first party tort of bad faith. *Kay v. Econ. Fire & Cas. Co.*, 284 Ark. 11, 678 S.W.2d 365 (1984); *Employers Equitable Life Ins. Co.*, 282 Ark. 29, 665 S.W.2d 873.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes. *See, e.g.*, *Cincinnati Life Ins. Co. v. Mickles*, 85 Ark. App. 188, 148 S.W.3d 768 (2004); *Columbia Nat. Ins. Co. v. Freeman*, 347 Ark. 423, 64 S.W.3d 720 (2002); *S. Farm Bureau Cas. Ins. Co. v. Allen*, 326 Ark. 1023, 934 S.W.2d 527 (1996); *Viking Ins. Co. of Wis. v. Jester*, 310 Ark. 317, 836 S.W.2d 371 (1992).

    - An award of punitive damages is justified only where the evidence indicates that the defendant acted wantonly in causing the injury or with such a conscious indifference to the consequences that malice may be inferred. *D'Arbonne Const. Co., Inc. v. Foster*, 354 Ark. 304, 308, 123 S.W.3d 894, 898 (2003) (*citing Stein v. Lukas*, 308 Ark. 74, 823 S.W.2d 832 (1992); *Mo. Pac. R.R. v. Mackey*, 297 Ark. 137, 760 S.W.2d 59 (1988); *Nat'l By-Products, Inc. v. Searcy House Moving Co.*, 292 Ark. 491, 731 S.W.2d 194 (1987)).

- Are punitive damages insurable?

    - In Arkansas, punitive damages are insurable. *S. Farm Bureau Cas. Ins. Co. v. Daniel*, 246 Ark. 849, 440 S.W.2d 582 (1969).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Whether punitive damages are recoverable for an insurer's bad faith failure to settle has not been addressed in Arkansas; however, because punitive damages can be recovered upon the proper showing for bad faith in general, and since punitive damages are

insurable, it is likely that they could be recovered as part of an excess verdict for an insurer's bad faith failure to settle.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - This issue has not been addressed by the Arkansas appellate courts; however, in *Union Ins. Co. v. Knife Co.*, 902 F. Supp. 877 (W.D. Ark. 1995), the District Court for the Western District of Arkansas held that a conflict of interest created in a trademark infringement case brought against the insured when the insurer assumed the duty to defend under a reservation of rights on the intentional infringement claim gave the insured the right, under Arkansas law, to name independent counsel of its own choosing.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - This issue has not been addressed by the Arkansas appellate courts; however, the Arkansas Supreme Court has held that an insured, not the insurer, is the lawyer's client, *First American Carriers, Inc. v. Kroger Co.*, 302 Ark. 86, 787 S.W.2d 669 (1990), and that *the client* is bound by the acts of its attorney. *Peterson v. Worthen Bank & Trust Co., N.A.*, 296 Ark. 201, 753 S.W.2d 278 (1988).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. However, a third party may be entitled to the 12% penalty and attorney's fees under A.C.A. § 23-79-208(a)(1) when the third party obtains a judgment against an insured and the judgment remains

unsatisfied after thirty days. *See Simmons First Nat'l Bank v. Liberty Mut. Ins. Co.*, 282 Ark. 194, 667 S.W.2d 648 (1984).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. A third party may not bring a direct action for common law bad faith against an insurer, but may obtain an assignment of an insured's right to bring such an action. *See, e.g.*, *Freeman v. Colonia Ins. Co.*, 319 Ark. 211, 890 S.W.2d 270 (1995); *RLI Ins. Co. v. Coe*, 306 Ark. 337, 813 S.W.2d 783 (1991).

CALIFORNIA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Cal. Insurance Code § 790.03(h):

        - *"The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance."*

        - The statute does not create a private right of action. *Moradi-Shalal v. Fireman's Fund Ins. Co.* (1988) 46 Cal. 3d 287. But the listed conduct can be evidence of common law bad faith.

        - Regulations promulgated in connection with the statute include, among other things, standards for an insurer's files and documentation, rules regarding the representation of policy provisions, training requirements for insurance personnel, standards for settlement of claims, and additional requirements for particular types of insurance including auto insurance, property insurance, surety, and life and disability insurance. 10 CCR §2695.1 et seq. (the Fair Claims Settlement Practices Regulations).

    - Business and Professions Code § 17200 (regarding unfair business practices generally) does not provide a statutory basis for a bad faith claim according to *Safeco Ins. Co. of America v. Superior Court (Hanna)* (1990) 216 Cal. App. 3d 1491, 1494, but see *State Farm Fire & Casualty Co. v. Superior Court* (1996) 45 Cal. App. 4th 1093 (Business and Professions Code § 17200 does provide a basis for an action for an injunction). As of July 2012, the issue was before the Supreme Court in *Zhang v. Superior Court*, Supreme Court Case No. S178542.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - *Gruenburg v. Aetna Insurance Co*. (1973) 9 Cal. 3d 566.
      In every insurance contract there is an implied covenant of good faith and fair dealing that neither party will do anything to injure the right of the other to receive the benefits of the contract. The duty to so act is immanent in the contract whether the company is attending to the claims of third persons against the insured or the claims of the insured itself. Where an insurer fails to deal *fairly and in good faith* with its insured by refusing, without proper cause, to compensate its insured for a loss covered by the policy, such conduct may give rise to a cause of action in tort for breach of an implied covenant of good faith and fair dealing.

    - *Communale v. Traders & General Ins. Co.* (1958) 50 Cal 2d. 654, 658.
      The insurer, in deciding whether a claim should be compromised, must take into account the interest of the insured and give it at least as much consideration as it does to its own interest. When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement which can be made within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim. Its unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing.

    - *Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 819.
      The duty of good faith and fair dealing implied in every insurance contract includes a duty on the part of the insurer to investigate claims submitted by its insured. "[A]n insurer cannot reasonably and in good faith deny payments to its insured without thoroughly investigating the foundation for its denial."

    - *Vu v. Prudential Property & Casualty Ins. Co.* (2001) 26 Cal. 4th 1142, 1150-51.
      The insurer-insured relationship is not a fiduciary relationship but is fiduciary-like and the insurer has special and heightened duties.

    - *Kransco v. American Empire Surplus Lines* (2000) 23 Cal. 4th 390.

While the covenant of good faith and fair dealing runs both ways, the insurer's breach is governed by tort principles and remedies and the insured's breach is governed by contract principles and remedies. The insured's breach of contract does not excuse the insurer's obligation to comply with the covenant of good faith and no comparative fault principle applies.

- What are the applicable statutes of limitations?

    - 4 years: Cal Code Civ Proc § 337(1); *Communale v. Traders & General Ins. Co.* (1958) 50 Cal 2d. 654, 662-63.

    - 2 years: Cal. Code Civ. Proc. § 339(1); *Richardson v. Allstate Ins. Co.* (1981) 117 Cal. App. 3d 8, 13.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Genuine dispute over legal liability: *Chateau Chamberay Homeowners Ass'n v. Associated Intern. Ins. Co.* (2001) 90 Cal. App. 4th 335, 346-47. This doctrine has been applied to factual disputes, as well: See *Wilson v. 21st Century Ins. Co. (2007)* 42 Cal. 4th 713, 723; *Fraley v. Allstate Ins. Co.* (2000) 81 Cal. App. 4th 1282, 1292. However, it does not apply in a bad faith refusal to settle case where the dispute is over whether there is coverage. *Howard v. American Nat. Fire Ins. Co.* (2010) 187 Cal. App. 4th 498, 530 ("the only permissible consideration in evaluating the reasonableness of the settlement offer becomes whether, in light of the victim's injuries and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the settlement offer.").

    - There can be no bad faith unless there is coverage: *Benavides v. State Farm General Ins. Co.* (2006) 136 Cal. App. 4th 1241, 1250-51.

    - Benefits must be withheld unreasonably and without proper cause: *Love v. Fire Ins. Exchange* (1990) 221 Cal. App. 1136, 1151; *California Shoppers, Inc. v. Royal Globe Ins. Co.* (1985) 175 Cal. App. 3d 1, 54-55.

    - Advice of counsel can be a defense but assertion of it may waive attorney-client privilege. *State Farm Mut. Auto. Ins. Co. v. Superior*

Court (1991) 228 Cal. App. 3d 721, 725-26 (advice of counsel need not be affirmatively alleged); *Transamerica Title Ins. Co. v. Superior Court* (1987) 188 Cal. App. 3d 1047, 1053 (assertion of defense generally waives privilege as to communications and documents relating to the advice).

- What are the recoverable damages for the bad faith cause of action?

    - For wrongful refusal to settle, the insurer can be liable for the entire resulting judgment, even if in excess of policy limits:

        - *Comunale v. Traders & General Ins. Co.* (1958) 50 Cal. 2d 654, 660 ("It is generally held that since the insurer has reserved control over the litigation and settlement it is liable for the entire amount of a judgment against the insured, including any portion in excess of the policy limits, if in the exercise of such control it is guilty of bad faith in refusing a settlement.") The same rule applies if the insurer wrongly refuses to defend and wrongly refuses a reasonable settlement. *Id.*

    - Tort damages including emotional distress from financial loss:

        - *Gruenburg v. Aetna Insurance Co*., 9 Cal. 3d 566 (1973): In bad faith action it was not essential to allege "extreme" and "outrageous" conduct to claim emotional distress, as required in an action for the independent tort of intentional infliction of emotional distress, where plaintiff also alleged he suffered loss of earnings, he was compelled to go out of business, he was unable to pay his business creditors and incurred the costs of defending law suits brought by them, and he incurred medical expenses. (But pre-judgment interest allowed in personal injury actions does not apply to emotional distress damages: *Gourley v. State Farm Mutual Auto. Ins. Co.* (1991) 53 Cal. 3d 121).

        - *Waters v. United Services Auto. Assn.* (1996) 41 Cal. App. 4th 1063: No emotional distress damages are recoverable without a showing of financial loss.

        - *PPG Industries, Inc. v. Transamerica Ins. Co.* (1999) 20 Cal. 4th 310, 315: "Because breach of the implied covenant is actionable as a tort, the measure of damages for tort actions applies and the insurance company generally is liable for

'any damages which are the proximate result of that breach.'"

- Attorneys' fees in proving coverage, but not in proving bad faith:

  - *Brandt v. Superior Court* (1985) 37 Cal. 3d 81: When an insurer commits bad faith, compelling an insured to sue to recover policy benefits, the attorneys' fees incurred in proving coverage are part of the damages caused by the bad faith.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes, under Cal. Civil Code §3294, punitive damages are recoverable for fraud, oppression and malice proved by clear and convincing evidence. *Neal v. Farmers Ins. Exchange* (1978) 21 Cal. 3d 910, 922.

- Are punitive damages insurable?

  - Punitive Damages are not insurable. *City Products Corp. v. Globe Indemnity Co.* (1979) 88 Cal. App. 3d 31 (covering punitive damages would violate Insurance Code §533 which bars coverage for willful acts, and would undermine the public policy purpose of punitive damages to punish the offender); *Peterson v. Superior Court* (1982) 31 Cal. 3d 147, 157-59 (same).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - Punitive Damages assessed against the insured cannot be recovered from the insurer as damages for bad faith refusal to settle. *PPG Industries, Inc. v. Transamerica Ins. Co.* (1999) 20 Cal. 4th 310, 313 ("Although the insurance company's alleged negligent failure to settle the third party lawsuit was a cause in fact of the punitive damages awarded against the insured, it was not a proximate cause of those damages. We therefore conclude that the insured in this case cannot shift to the insurance company its responsibility for the punitive damages.")

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - Yes, *Cumis* is a California case. *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal. App. 3d 358. However, the rule has been modified and codified in Cal. Civil Code §2860:

(a) If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel. An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section.

(b) For purposes of this section, a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage; however, when an insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim, a conflict of interest may exist. No conflict of interest shall be deemed to exist as to allegations of punitive
damages or be deemed to exist solely because an insured is sued for an amount in excess of the insurance policy limits.

(c) When the insured has selected independent counsel to represent him or her, the insurer may exercise its right to require that the counsel selected by the insured possess certain minimum qualifications which may include that the selected counsel have (1) at least five years of civil litigation practice which includes substantial defense experience in the subject at issue in the litigation, and (2) errors and omissions coverage. The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees or providing for methods of settlement of disputes concerning those fees. Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and

binding arbitration by a single neutral arbitrator selected by the parties to the dispute.

(d) When independent counsel has been selected by the insured, it shall be the duty of that counsel and the insured to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action. Any claim of privilege asserted is subject to in camera review in the appropriate law and motion department of the superior court. Any information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.

(e) The insured may waive its right to select independent counsel by signing the following statement:
"I have been advised and informed of my right to select independent counsel to represent me in this lawsuit. I have considered this matter fully and freely waive my right to select independent counsel at this time. I authorize my insurer to select a defense attorney to represent me in this lawsuit."

(f) Where the insured selects independent counsel pursuant to the provisions of this section, both the counsel provided by the insurer and independent counsel selected by the insured shall be allowed to participate in all aspects of the litigation. Counsel shall cooperate fully in the exchange of information that is consistent with each counsel's ethical and legal obligation to the insured. Nothing in this section shall relieve the insured of his or her duty to cooperate with the insurer under the terms of the insurance contract.

- Not every reservation of rights creates a conflict of interest. Only those the outcome of which can be controlled by defense counsel create a conflict of interest requiring the appointment of independent counsel.

  - *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal. App. 4th 1388, 1419-24; *Long v. Century Indem. Co.* (2008) 163 Cal. App. 4th 1460 (discussion of statute and cases).

  - *McGee v. Superior Court* (1985) 176 Cal. App. 3d 221 (reservation of rights on resident relative exclusion did not create conflict).

        - *Native Sun Investment Group v. Ticor Title Ins. Co.* (1987) 189 Cal. App. 3d 1265 (defense of covered and uncovered claims did not create conflict when attorney given carte blanche to litigate all issues).

        - *Foremost Ins. Co. v. Wilks* (1988) 206 Cal. App. 3d 251 (a conflict is not created by a reservation of rights on coverage disputes that have nothing to do with the issues being litigated in the underlying action).

        - *Dynamic Concepts; Blanchard v. St. Farm Fire & Casualty Co.* (1991) 2 Cal. App. 4th 345, 350 (assertion of rights to seek reimbursement of defense costs allocable to uncovered claims does not create conflict). Accord: *James 3 Corp. v. Truck Ins. Co.* (2001) 91 Cal. App. 4th 1093, 1108-09.

    - *San Gabriel Water Valley Company v. Hartford Acc. & Ind. Co.* (2000) 82 Cal. App. 4th 1230, 1239 (fee cap applies collectively when multiple insurers are defending).

    - *Intergulf Development v. Superior Court* (2010) 183 Cal. App. 4th 16 (disputes over amount of fees are arbitrable under statute but disputes over breach of duty to defend are not); *Compulink Management Center, Inc. v. St. Paul Fire and Marine Ins. Co.* (2008) 169 Cal. App. 4th 289, 300 (fees questions must be arbitrated even if other issues are present), but see *Fireman's Fund Ins. Companies v. Younesi* (1996) 48 Cal. App. 4th 451 (arbitration required only when amount of fees is sole issue).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No. *Merritt v. Reserve Ins. Co.* (1973) 34 Cal. App. 3d 858, 880-82 ("Having chosen competent independent counsel to represent the insured in litigation, the carrier may rely upon trial counsel to conduct the litigation, and the carrier does not become liable for trial counsel's legal malpractice. If trial counsel negligently conducts the litigation, the remedy for this negligence is found in an action against counsel for malpractice and not in a suit against counsel's employer to impose vicarious liability.")

- Insurer remains liable for failure to employ competent counsel: *Merritt v. Reserve Ins. Co.* (1973) 34 Cal. App. 3d 858, 882 ("Reserve, of course, remains liable for the negligent performance of its own duties. Under the policy Reserve assumed three principal duties in relation to the assured: (1) to make immediate inquiry into the facts of any serious accident as soon as practicable after its occurrence; (2) on the filing of suit against its assured to employ competent counsel to represent the assured and to provide counsel with adequate funds to conduct the defense of the suit; (3) to keep abreast of the progress and status of the litigation in order that it may act intelligently and in good faith on settlement offers. The conduct of the actual litigation, including the amount and extent of discovery, the interrogation, evaluation, and selection of witnesses, the employment of experts, and the presentation of the defense in court, remains the responsibility of trial counsel, and this is true both on plaintiff's side and on defendant's side of the case."

- See also *Lynn v. Superior Court* (1986) 180 Cal. App. 3d 346 (Landlords' attorney was an independent contractor and in the absence of showing of ratification of attorney's conduct or any other act by landlords endorsing or approving attorney's action with respect to unlawful detainer proceeding, landlords could not be held vicariously liable for alleged tortious conduct of attorney).

- But see, *Barney v. Aetna Casualty & Surety Co.* (1986) 185 Cal. App. 3d 966, 979 (insured can state a claim for conspiracy between insurer and defense counsel to prejudice insured's rights).

- See also *Oei v. N. Star Capital Acquisitions, LLC* (C.D. Cal. 2006) 486 F. Supp. 2d 1089, 1096 n.28 (insurer not protected from vicarious liability for acts of "nonlegal" conduct of lawyer, such as acting as debt collector and doing something that "is not an activity that only attorneys have 'authority' to perform due to their professional license").

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No, Cal. Ins. Code §790.03 does not establish a private right of action. *Moradi-Shalal v. Fireman's Fund Ins. Co.* (1988) 46 Cal. 3d 287.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No, a third party may not maintain an action for bad faith against another's insurer. *Moradi-Shalal v. Fireman's Fund Ins. Co.* (1988) 46 Cal. 3d 287.

    - However, a third party may maintain traditional causes of action for fraud, intentional infliction of emotional distress, including claims for punitive damages. *Moradi-Shalal v. Fireman's Fund Ins. Co.* (1988) 46 Cal. 3d 287, 304-05.

COLORADO

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Effective August 5, 2008, Colorado has an additional First Party statutory remedy: CRS (Colorado Revised Statutes) 10-3-1115 and 1116.

        - The statutory action is in addition to any common law cause of action. *Kisselman v. American Family Mut. Ins. Co.* (Colo. Ct. App., Dec. 8, 2011, 10CA1453) 2011 WL 6091708 ("the Statutes create a new private right of action in addition to and different from common law bad faith claims).

        - The statute reduces the burden of proof from unreasonable and the carrier knew or should have known its conduct was unreasonable to just a question of whether the carrier was reasonable in its actions. *Kisselman v. American Family Mut. Ins. Co.* (Colo. Ct. App., Dec. 8, 2011, 10CA1453) 2011 WL 6091708. *Vacaro v. American Family Ins. Group* (Colo. Ct. App. Jan. 19, 2012, 275 P.3d 750, 756 ("Thus, '[t]he standard contained in § 1115 arguably is less onerous on the insured, and the remedies contained in § 1116 are more financially threatening to the insurer than a traditional common law bad faith claim.'").

        - The statute applies prospectively to post-effective date conduct of insurers. *Kisselman v. American Family Mut. Ins. Co.* (Colo. Ct. App., Dec. 8, 2011, 10CA1453) 2011 WL 6091708.

- It excludes worker's compensation and title insurance.

- Statutory damages include double the benefit in question and attorney fees.

- The statute specifically does not abolish any other cause of action, but tries to preclude double recovery of damages.

- **CRS 10-3-1104. UNFAIR METHODS OF COMPETITION AND UNFAIR OR DECEPTIVE ACTS OR PRACTICES**

  (h) Unfair claim settlement practices: Committing or performing, either in willful violation . . . ;

  (IV) Refusing to pay claims without conducting a reasonable investigation based upon all available information; or

  (V) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed; or

  (VI) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear; or

  (VII) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds; or

  (VIII) Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application; or

  (XI) Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration; or

  (XII) Delaying the investigation or payment of claims by requiring an insured or claimant, or the physician of either of them, to submit a

preliminary claim report, and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information; or

(XIII) Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage . . .

- **CRS 6-1-101 et seq. COLORADO CONSUMER PROTECTION ACT**

  - For purposes of a private right of action, "any person" means a person who establishes that: (1) The defendant engaged in an unfair or deceptive trade practice; (2) the challenged practice occurred in the course of the defendant's business, vocation, or occupation; (3) it significantly impacts the public as actual or potential customers of the defendant's goods, services, or property; (4) the plaintiff suffered injury in fact to a legally protected interest; and (5) the challenged practice caused the plaintiff's injury. CRS 6-1-113; *Hall v. Walter*, 969 P.2d 224 (Colo. 1998); *Anson v. Trujillo*, 56 P.3d 114 (Colo. App. 2002); *Loughridge v. Goodyear Tire & Rubber Co.*, 192 F. Supp.2d 1175 (D. Colo. 2002).

  - A private cause of action by an insured against an insurer under the CO Consumer Protection Act is not preempted by the Colorado unfair competition - deceptive practices act CRS 10-3-1101 to 10-3-1114. *Showpiece Homes Corp. v. Assurance Co. of America*, 38 P.3d 47 (Colo. 2001).

  - If a wrong is private in nature, and does not affect the public, a claim is not actionable under the Colorado Consumer Protection Act (CCPA). *Sewell v. Great Northern Ins. Co.*, 535 F.3d 1067 (2008). To determine whether a practice challenged under the Colorado Consumer Protection Act (CCPA) significantly impacts the public, courts should consider: (1) the number of consumers directly affected by the challenged practice, (2) the relative sophistication and bargaining power of the consumers

affected by the challenged practice, and (3) evidence that the challenged practice has previously impacted other consumers or has the significant potential to do so in the future. Id. at 1097. See *HealthONE of Denver, Inc. v. UnitedHealth Group Inc.,* 805 F.Supp.2d 1115 (2011).

- A wrong that is private in nature, and does not affect the public, does not give rise to liability under the Colorado Consumer Protection Act; thus, where the challenged conduct amounts to nothing more than a breach of a private contract between the parties, it is difficult to conceive of a public interest in the matter. *Tara Woods Ltd. Partnership v. Fannie* Mae, 731 F.Supp.2d 1103 (2010).

- The Colorado Consumer Protection Act (CCPA) is not intended to provide additional remedies to claimants whose disputes have no public impact, but are purely private transactions. *Alpine Bank v. Hubbell*, 506 F.Supp.2d 388 (2007). See *Sewell v. Great Northern Ins. Co.*, 535 F.3d 1067 (2008).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Claims for bad faith breach of insurance contract arise in first-party and third-party contexts. First-party bad faith cases involve an insurance company refusing to make or delaying payments owed directly to its insured under a first-party policy such as life, health, disability, property, fire, or no-fault auto insurance. *Farmers Group, Inc. v. Williams*, 805 P.2d 419, 421 (Colo. 1991). See *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1141 (1984). John H. Bauman, *Emotional Distress Damages and the Tort of Insurance Bad Faith*, 46 Drake L. Rev. 717, 739 (1998).

  - In "first party" bad faith insurance cases where an insured sues his insurance company directly, the plaintiff must prove that the conduct of the insurer was unreasonable, and that the insurer knew that its conduct was unreasonable or acted in reckless disregard of whether it was unreasonable. *Cary v. United of Omaha Life Ins. Co.*,

68 P.3d 462, 469 (Colo. 2003); *Kisselman v. American Family Mut. Ins. Co.* (Colo. Ct. App., Dec. 8, 2011, 10CA1453) 2011 WL 6091708; see COLO. JURY INST. (4TH CIV.) 25:2 (2012).

- The *basis* for liability in tort for the breach of an insurer's implied duty of good faith and fair dealing is grounded upon the special nature of the insurance contract and the relationship which exists between the insurer and the insured. The motivation of the insured when entering into an insurance contract differs from that of parties entering into an ordinary commercial contract. By obtaining insurance, an insured seeks to obtain some measure of financial security and protection against calamity, rather than to secure commercial advantage. *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1272 (Colo. 1985); see *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1141 (1984).

- In a first-party bad faith case, the conduct of an insurer is measured using two elements: "unreasonable conduct, and knowledge that the conduct is unreasonable or a reckless disregard for the fact that the conduct is unreasonable." *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1272 (Colo. 1985).

- In a first-party context, where the insured has not ceded to the insurer the right to represent his or her interests, there is no quasi-fiduciary duty. *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1274 (Colo. 1985). Therefore, the standard of conduct is different. In addition to proving that the insurer acted unreasonably under the circumstances, a first-party claimant must prove that the insurer either knowingly or recklessly disregarded the validity of the insured's claim. This standard of care "reflects a reasonable balance between the right of an insurance carrier to reject a non-compensable claim submitted by its insured and the obligation of such carrier to investigate and ultimately approve a valid claim." *Id.* at 1275.

- In the third party context, bad faith can arise from an insurer's actions that expose the insured to being personally liable for the monetary obligations underlying the insured's claims. *Goodson v. Am. Std. Ins. Co.*, 89 P.3d 409, 414 (Colo. 2004); see COLO. JURY INST. (4TH CIV.) 25:2 (2012).

- The reasonableness of the insurer's conduct must be determined objectively, based on proof of industry standards. The aid of expert witnesses is often required in order to establish objective evidence of industry standards. See *Redden v. SCI Colorado Funeral Services, Inc.*, 38 P.3d 75, 81 (Colo. 2001) (stating that in most cases of professional negligence the applicable standard must be established by expert testimony because it is not within the common knowledge and experience of ordinary persons). See also *Goodson v. Am. Std. Ins. Co.*, 89 P.3d 409, 415 (Colo. 2004).

- Third-party bad faith arises when an insurance company acts unreasonably in investigating, defending, or settling a claim brought by a third person against its insured under a liability policy. The insurance company's duty of good faith and fair dealing extends only to the insured, not to the third-party. In the third-party context, an insurance company stands in a position of trust with regard to its insured; a quasi-fiduciary relationship exists between the insurer and the insured. *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1141 (1984). See also *Goodson v. Am. Std. Ins. Co.*, 89 P.3d 409, 415 (Colo. 2004). Because of the quasi-fiduciary nature of the insurance relationship in a third-party context, the standard of conduct required of the insurer is characterized by general principles of negligence. *Id.* at 1142.

- To establish that the insurer breached its duties of good faith and fair dealing, the insured must show that a reasonable insurer under the circumstances would have paid or otherwise settled the third-party claim. *Farmers Group, Inc. v. Trimble*, 691 P.2d at 1142. See also *Goodson v. Am. Std. Ins. Co.*, 89 P.3d 409, 415 (Colo. 2004).

- What are the applicable statutes of limitations?

  - Claims for bad faith breach and willful and wanton breach of an insurance contract are governed by a two-year statute of limitations. CRC 13-80-102 (2002).

  - The action accrues on the date on which both the injury and its cause are known or should have been known through the exercise of reasonable diligence. CRC 13-80-108 (2002); *Pham v. State Farm*

Mut. Auto. Ins. Co., 70 P.3d 567 (Colo. Ct. App. 2003).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Under the tort of bad faith an insurance company may challenge claims which are fairly debatable and will be found liable only where it has intentionally denied (or failed to process or pay) a claim without a reasonable basis.

    - If an insurer does not know that its denial of or delay in processing a claim filed by its insured is unreasonable, and does not act with reckless disregard of a valid claim, the insurer's conduct would be based upon a permissible, albeit mistaken, belief that the claim is not compensable. *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1275 (Colo. 1985).

    - It is reasonable for an insurer to challenge claims that are fairly debatable. *Vaccaro v. American Family Ins. Group*, 275 P.3d 750, 759 (2012)(citing *Zolman v. Pinnacol Assur.*, 261 P.3d 490, 496 (Colo. App. 2011)). If a reasonable person would find that the insurer's explanation for delaying payment of a claim was "fairly debatable," this weighs against a finding that the insurer acted unreasonably. Id. See *Sanderson v. Am. Family Mut. Ins. Co.*, 251 P.3d 1213, 1217 (Colo. App. 2010).

- What are the recoverable damages for the bad faith cause of action?

    - **UNFAIR COMPETITION - DECEPTIVE PRACTICES ACT - C.R.S. 10-3-1109 (2006)**

      Penalty for violation of cease and desist orders

      (a) Not more than ten thousand dollars for each and every act or violation of an insurer; or a monetary penalty of not more than five hundred dollars for each and every act or violation of an individual;

      (b) Suspension or revocation of such person's license.

- **CO. CONSUMER PROTECTION ACT - C.R.S. 6-1-113 (2006)**

  (1) The provisions of this article shall be available in a civil action for any claim against any person who has engaged in or caused another to engage in any deceptive trade practice listed in this article. An action under this section shall be available to any person who:

  (a) The greater of:

  (I) The amount of actual damages sustained; or

  (II) Five hundred dollars; or

  (III) Three times the amount of actual damages sustained, if it is established by clear and convincing evidence that such person engaged in bad faith conduct; plus

  (b) In the case of any successful action to enforce said liability, the costs of the action together with reasonable attorney fees as determined by the court.

- Compensatory damages for economic and non-economic losses are available to make the insured whole, and, where appropriate, punitive damages are available to punish the insurer and deter wrongful conduct by other insurers. *Ballow v. PHICO Ins. Co.*, 878 P.2d 672, 677 (Colo. 1994); Restatement (Second) of Torts §§ 901-909 (1979).

  - <u>*Non-economic losses*</u> recognized under the rubric of compensatory damages include emotional distress; pain and suffering; inconvenience; fear and anxiety; and impairment of the quality of life.

  - An insured suing under the tort of bad faith breach of an insurance contract is entitled to recover damages based upon traditional tort principles of compensation for injuries actually suffered, including emotional distress.*Ballow v. PHICO Ins. Co.*, 878 P.2d 672, 677 (Colo. 1994)

- In a tort claim against an insurer for breach of the duty of good faith and fair dealing, the plaintiff may recover damages for **emotional distress** without proving substantial property or economic loss. *Goodson v. Am. Std. Ins. Co.*, 89 P.3d 409, 415 (Colo. 2004).

- Are punitive damages recoverable? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. To recover punitive damages, the insured must establish that the insurer's breach was accompanied by circumstances of fraud, malice, or willful and wanton conduct. §13-21-102(1)(a), 5 C.R.S. (2003); *Lira v. Shelter Ins. Co.*, 913 P.2d 514, 517. A punitive damages award cannot exceed the amount of actual damages and, in certain situations, may be increased or decreased by the court. §13-21-102(1)-(3), 5 C.R.S. (2003).

    - Punitive damages require a higher burden of proof and require insureds to establish the requisite attendant circumstances beyond a reasonable doubt**.** CRS 13-25-127(2) (2003); *Goodson v. Am. Std. Ins. Co.*, 89 P.3d 409, 415-16 (Colo. 2004) ("punitive damages are available to punish insurer and deter wrongful conduct by other insurers"). See also Rest. (Second) of Torts §§901-909.

- Are punitive damages insurable?

    - Insuring punitive damages is against public policy. *Lira v. Shelter Ins. Co.,* 913 P.2d 514 (1996) (En Banc); *Bohrer v. Church Mut. Ins. Co.* (Colo. Ct. App. 2000) 12 P.3d 854, 856 ("public policy prohibits an insurance carrier from providing insurance coverage for punitive damages," so it would be against public policy for an insurance policy to cover interest on punitive damages).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Insurer's duty to settle did not include duty to protect insured from exposure to punitive damages, and insured could not recover those

punitive damages for the insurers' refusal to settle. *Lira v. Shelter Ins. Co.,* 913 P.2d 514, 517 (1996) (En Banc).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No such cause of action has been recognized.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - **CRS 6-1-113. COLORADO CONSUMER PROTECTION ACT**

        - The plain language of this section provides that any person may bring an action under the Colorado Consumer Protection Act (CCPA). Therefore, third-party non-consumers have standing to bring actions under the CCPA. *Walter v. Hall*, 940 P.2d 991 (Colo. App. 1996), aff'd, 969 P.2d 224 (Colo. 1998). *Walter* is not an insurance case.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. The insurance company's duty of good faith and fair dealing extends only to the insured, not to the third-party. In the third-party context, an insurance company stands in a position of trust with regard to its insured; a quasi-fiduciary relationship exists between the insurer and the insured. *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1141. (1984).

- What are the recoverable damages for the bad faith cause of action?

    - **CO. CONSUMER PROTECTION ACT - C.R.S. 6-1-113 (2006)**

        (1) The provisions of this article shall be available in a civil action for any claim against any person who has engaged in or caused another to engage

in any deceptive trade practice listed in this article. An action under this section shall be available to any person who:

(a) The greater of:

(I) The amount of actual damages sustained; or

(II) Five hundred dollars; or

(III) Three times the amount of actual damages sustained, if it is established by clear and convincing evidence that such person engaged in bad faith conduct; plus

(b) In the case of any successful action to enforce said liability, the costs of the action together with reasonable attorney fees as determined by the court.

CONNECTICUT

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes

- Can third parties sue for bad faith (i.e., third party bad faith)? No, not unless the third party is subrogated to the rights of the insured.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - In Connecticut, insurance practices are subject to two regulatory acts, the Connecticut Unfair Insurance Practices Act ("CUIPA") and the Connecticut Unfair Trade Practices Act ("CUTPA"). A private cause of action exists under CUTPA to enforce CUIPA violations. *Mead v. Burns*, 199 Conn. 651, 663 (1986). In order to sustain a CUIPA cause of action under CUTPA, a plaintiff must allege conduct that is proscribed by CUIPA. *Nazami v. Patrons Mutual Ins. Co.*, 280 Conn. 619, 625 (2006).

        - Conn. Gen. Stat. §42-110a-110q: Unfair Trade Practices Act

            - In determining whether a particular act or practice violates CUTPA, Connecticut courts "have adopted the criteria set out in the cigarette rule by the federal trade commission for determining when [an act or] practice is unfair: (1) whether the practice, without necessarily having been previously considered unlawful, offends a public policy established by statutes, the common law or otherwise-whether, in other words, it is within at least the penumbra of some common law, statutory, or otherwise established concept of unfairness; (2) whether it is immoral, unethical, oppressive, or unscrupulous; (3) whether it causes substantial injury to consumers."

Jacobs v. Healey Ford-Subaru, Inc., 231 Conn. 707, 725, 725 (1995).

- Conn. Gen. Stat. §38a-815 et seq.: Unfair Insurance Practices Act ("CUIPA")

    - Conn. Gen. Stat. §38a-816(6) defines Unfair claim settlement practices.

        - A CUTPA claim based on 38a-816(6) requires proof that the unfair settlement practices were committed or performed with such frequency as to indicate a general business practice. *Lee v. Middlesex Ins. Co.*, 229 Conn. 842, 850 (1994). Alleged improper handling of a single insurance claim, without any evidence of misconduct by the defendant in the processing of any other claim does not rise to the level of a general business practice as required by CUIPA. *Id.* at 849.

- Neither the Supreme Court nor the Connecticut Appellate Court have ruled on whether CUIPA allows a private cause of action independent of CUTPA. *H & L Chevrolet, Inc. v. Berkley Ins. Co.*, 110 Conn. App. 428, 441 (2008); *Carford v. Empire Fire and Marine Ins. Co.*, 94 Conn. App. 41, 52-53 (2006).

    - Connecticut superior court decisions are split, with a majority of the decisions concluding that CUIPA alone does not provide for a private right of action.

        - "The consensus of these courts may be summarized as follows: 1) there is no express authority under CUIPA for private causes of action; 2) CUIPA is not ambiguous; 3) the regulatory scheme under CUIPA contemplates investigation and enforcement actions to be taken by the insurance commissioner; and 4) consequently there is no private cause of action under CUIPA." *Watton v. Geico Indemnity Co .,* Superior

Court, judicial district of Hartford, Docket No. CV 08 5018837 (November 13, 2008, Aurigemma, J.).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Breach of good faith and fair dealing/Bad Faith

        - "To constitute a breach of the implied covenant of good faith and fair dealing, the acts by which a defendant allegedly impedes the plaintiff's right to receive benefits that he or she reasonably expected to receive under the contract must have been taken in bad faith." *Alexandru v. Strong*, 81 Conn. App. 68, 80-81 (2004). See also *L.F. Pace & Sons, Inc. v. Travelers Indemnity Co.*, 9 Conn. App. 30, 46 (1986).

        - "Bad faith in general implies both 'actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive.' [Citation omitted.] Bad faith means more than mere negligence; it involves a dishonest purpose." *Habetz v. Condon*, 224 Conn. 231, 237-38 (1998). Absent allegations and evidence of a dishonest purpose or sinister motive, a claim for breach of the implied covenant of good faith and fair dealing is legally insufficient. See, e.g., *Feinberg v. Berglewicz,* 32 Conn. App. 857, 862 (1993).

        - "Bad faith is defined as the opposite of good faith, generally implying a design to mislead or to deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation not prompted by an honest mistake as to one's rights or duties. Bad faith is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity. It contemplates a state of mind affirmatively operating with furtive design or ill will." *Hutchinson v. Farm Family Casualty Ins. Co.,* 273 Conn. 33, 42 n. 4 (2005). "Neglect or refusal to

fulfill a contractual obligation can be bad faith only if prompted by an interested or sinister motive." *Feinberg v. Berglewicz,* 32 Conn.App. 857, 862 (1993).

- What are the applicable statutes of limitations?

    - Three-year statute of limitations for unfair and deceptive trade practices commences when the violations occur. Conn. Gen. Stat. §42-110g (f).

    - Three-year statute of limitations for bad faith tort claims commences when the action complained of occurs. Conn. Gen. Stat. § 52-577.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - See above requirements for proving bad faith.

- What are the recoverable damages for the bad faith cause of action?

    - Plaintiffs are entitled to actual damages, punitive damages, costs and reasonable attorney's fees, and other appropriate equitable relief deemed just and proper. Conn. Gen. Stat. §42-110g (a).

    - "When liability under CUTPA is established, attorney's fees and costs may be awarded at the discretion of the court and the successful litigant must be given the opportunity at trial to provide evidence to establish a basis for the award." *Ven Nguyen v. DaSilva,* 10 Conn.App. 527, 530 (1987). In the event of a trial by jury, culminating in a verdict for a plaintiff, Conn. Gen. Stat. §42-110g(d) authorizes a bifurcated proceeding in which the trial court, not the jury, may award attorney's fees. This remains subject to the general "requirement that the reasonableness of attorney's fees and costs must be proven by an appropriate evidentiary showing." *Smith v. Snyder,* 267 Conn. 456, 471 (2004).

    - In order to recover under CUTPA, there must be an ascertainable loss. An ascertainable loss is a deprivation, detriment or injury that is capable of being discovered, observed or established. A loss is

ascertainable if it is measurable even though the precise amount of the loss is not known. *Artie's Auto Body, Inc. v. Hartford Fire Ins. Co.*, 287 Conn. 208, 218 (2008).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - In order to award punitive or exemplary damages, evidence must reveal a reckless indifference to the rights of others or an intentional and wanton violation of those rights. *Votto v. American Car Rental, Inc.*, 273 Conn. 478, 485-86 (2005).

- Are punitive damages insurable?

    - Yes, in some cases. See *Bodnar v. United Services Automobile Assn*., 222 Conn. 480 (1992). In Connecticut common law punitive damages are limited to the plaintiff's attorney's fees and nontaxable costs, and thus function both as compensatory and punitive. A policy covering "all sums" or "damages" is construed to include punitive damages. *Id.* at 494-97. See also *Avis Rent A Car System, Inc. v. Liberty Mut. Ins. Co.* (1987) 203 Conn. 667.

    - However, punitive damages are not insurable under uninsured motorist coverage. *Bodnar v. United Services Automobile Assn*., 222 Conn. 480, 497-500 (1992). Different considerations apply because the plaintiff is recovering from his own insurer for the wrongdoing of another. See also .*Nationwide Mutual Insurance Company, et al. v. Pasiak*, Superior Court of Connecticut, Complex Litigation Docket at Judicial District of Stamford-Norwalk, Docket No. CV 08 4015401 (November 30, 2011); but see *Harris v. Hermitage Ins. Co., Superior Court of Connecticut*, Judicial District of Hartford, Docket No. CV 08 5021329 (October 13, 2009).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - It appears the insured may be able to recover assessed punitive damages from the insurer for bad faith failure to settle if punitive damages were covered by the policy language. See *Bodnar v. United*

Services Automobile Assn., 222 Conn. 480 (1992), discussed above stating punitive damages can be covered. Although there is no Connecticut case law directly on point, the Connecticut Superior Court, in determining whether the insurer was responsible to indemnify for the punitive award of the jury, looked to the language of the policy to determine if the policy provided language that could include a punitive award. See *Nationwide Mutual Insurance Company, et al. v. Pasiak,* Superior Court of Connecticut, Complex Litigation Docket at Judicial District of Stamford-Norwalk, Docket No. CV 08 4015401 (November 30, 2011).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - If the insurer can successfully argue that it hired independent counsel to represent the insured and it therefore may not be held vicariously liable for the negligence of the attorney under the independent contractor doctrine, the insurer will not be held liable for the malpractice of its appointed defense counsel. *Infinity Ins. Co. v. Worcester Ins. Co.,* Superior Court of Connecticut, Judicial District of Hartford, Docket No. CV 02 0817023 (March 18, 2005).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - The right to assert a private cause of action under CUTPA for CUIPA violations does not extend to third parties absent subrogation or a judicial determination of the insured's liability. *Carford v. Empire Fire and Marine Ins. Co.*, 94 Conn. App. 41, 53 (2006).

    - Conn. Gen. Stat. §38a-321: Direct Action Statute

        - Provides that once a final judgment is rendered against an insured for loss or damage covered by a policy of insurance and the judgment remains unsatisfied for 30 days, the "judgment creditor shall be subrogated to all the rights of

the defendant and shall have a right of action against the insurer to the same extent that the defendant in such action could have enforced his claim against such insurer had such defendant paid such judgment."

- A party subrogated to the rights of an insured under the direct action statute obtains no different or greater rights against the insurer than the insured possesses and is equally subject to any defense the insurer may have against the insured under the policy. *Brown v. Employer's Reinsurance Corp.*, 206 Conn. 668, 673 (1988).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - The common law duty of good faith and fair dealing between an insurer and its insured does not extend to a third party, absent a third party beneficiary relationship. See *Carford v. Empire Fire and Marine Ins. Co.*, 94 Conn. App. 41, 46 (2006).

DELAWARE

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)?

  Yes

- Can third parties sue for bad faith (i.e., third party bad faith)?

  No. A third party can only bring a cause of action for bad faith if there is an assignment. *Rowlands v. PHICO Ins. Co.,* 2000 WL 1092134 (D. Del. July 27, 2000).

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

  - No

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Yes. Delaware recognizes a common law cause of action for the bad faith delay, or the nonpayment, of an insured's claim in a first-party insured-insurer relationship as a breach of contractual obligations. *Tackett v. State Farm Fire & Cas. Inc. Co.*, 653 A. 2d 254 (Del. 1995).

  - The Delaware Supreme Court held that an insurer can be liable for a "lack of good faith, or the presence of bad faith" "where the insured can show that the insurer's [action] was 'clearly without any reasonable justification.'" *Tackett v. State Farm Fire & Cas. Inc. Co.*, 653 A. 2d 254, 264 (Del. 1995) (quoting *Casson v. Nationwide Ins. Co.*, 455 A. 2d 361, 369 (Del. Super. Ct. 1982)).

- What are the applicable statutes of limitations?

    - Three years. 10 Del.C. § 8106.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - "[I]n order to establish 'bad faith' the plaintiff must show that the insurer's refusal to honor its contractual obligation was *clearly without any reasonable justification*… The ultimate question is whether at the time the insurer denied liability, there existed a set of facts or circumstances known to the insurer which created a bona fide dispute and therefore a meritorious defense to the insurer's liability." *Casson v. Nationwide Ins. Co.*, 455 A. 2d 361, 369 (Del. Super. Ct. 1982) [emphasis added].

    - "Advice of counsel" may be recognized as a defense, although asserting this defense may waive the attorney/client privilege. *Tackett v. State Farm Fire & Cas. Inc. Co.*, 653 A. 2d 254 (Del. 1995).

- What are the recoverable damages for the bad faith cause of action?

    - Contract damages, consequential damages (*Pierce v. Int'l Ins. Co. of Ill.*, 671, A.2d 1361, 1367 (Del. 1996)) attorney's fees (only if insured prevails against a property insurer), and punitive damages.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes. Punitive damages are recoverable for an intentional, egregious or malicious breach of an insurance contract. *Tackett v. State Farm Fire & Cas. Inc. Co.*, 653 A. 2d 254, 265 (Del. 1995); *Thomas v. Harford Mut. Ins. Co.*, 2004 WL 1102362 (Del. Super. Ct. Apr. 7, 2004); *Int'l Fid. Inc. Co. v. Delmarva Sys. Corp.,* 2001 WL 541469 (Del. Super. Ct. May 9, 2001).

    - The plaintiff must establish that the insurer's conduct was "outrageous,' because of 'evil motive' or 'reckless indifference to the rights of others…' Mere inadvertence, mistake, or errors of judgment which constitute mere negligence will not suffice."

Tackett v. State Farm Fire & Cas. Inc. Co., 653 A. 2d 254, 265 (Del. 1995) (quoting *Jardel v. Hughes*, 523 A. 2d 518, 529 (Del. Super. Ct. 1987)).

- Are punitive damages insurable?
    - Yes. *Whalen v. On Deck, Inc*. 514 A. 2d. 1072 (Del. 1986)
- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?
    - No reported decision.
- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?
    - No reported decision.
- Can an insurer be held liable for the malpractice of its appointed defense counsel?
    - There are no reported decisions.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.
    - No
- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.
    - No. A third party can only bring a cause of action for bad faith if there is an assignment. *Rowlands v. PHICO Ins. Co.*, 2000 WL 1092134 (D. Del. July 27, 2000).

FLORIDA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes per statute. There is no common law bad faith in first party policy situations.

- Can third parties sue for bad faith (i.e., third party bad faith)? Yes, under statute and common law.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. Fla. Stat. § 624.155, provides statutory grounds for first party bad faith, but only after the insurer is found to have breached the terms of the insurance contract, and only after the insurer has been given adequate notice of the alleged unfair claim practices and afforded sixty (60) days to cure the violations. Fla. Stat. § 626.9541 specifies the various kinds of unfair claims settlement practices that are actionable under § 624.155.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - There is no common law first party action for bad faith in Florida. *Butchikas v. Travelers Indemnity Co.*, 343 So. 2d 816 (Fla. 1976); *Baxter v. Royal Indem. Co.*, 285 So.2d 652 (Fla. 1st DCA 1973). Prior to the enactment of § 624.155 in 1982, Florida did not recognize first-party bad faith claims. In 2012, the Florida Supreme Court held that insurance contracts are not subject to the same implied duty of good faith and fair dealing as are all other contracts in Florida. Thus, policyholders who wish to bring bad faith claims in Florida on first-party property claims must do so pursuant to Fla. Stat. § 624.155, the statutory bad faith provision. *QBE Insurance Corp. v. Chalfonte Condominium Apartment Assoc., Inc.*, 2012 W.L. 1947863 (Fla. 2012).

- What are the applicable statutes of limitations?

    - Four years.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - In Florida, the determination of whether the insurer acted fairly and honestly towards its insured with due regard for the insured's interest is made by applying the "totality of the circumstances" test which requires consideration of all pertinent facts and circumstances. Florida does not follow the "fairly debatable" standard. *State Farm Mut. Auto Ins. Co. v. Laforet*, 685 So.2d 55 (Fla. 1995).

- What are the recoverable damages for the bad faith cause of action?

    - Consequential damages in excess of the policy limits. Fla. Stat. §624.155(8) "…*Damages recoverable pursuant to this section shall include those damages which are a reasonably foreseeable result of a specified violation of this section by the insurer and may include an award or judgment in an amount that exceeds the policy limits*."

    - Possibly emotional distress damages. *Time Ins. Co., Inc. v. Burger*, 712 So.2d 839 (Fla. 1998), although facts of case suggest that holding is limited to actions against health insurers.

    - Attorneys Fees. Fla. Stat. §624.155(4).

    - Interest. *McLeod v. Continental Ins. Co*., 591 So.2d 621 (Fla. 1992).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Possibly. Fla. Stat. §624.155 (5) states "*No punitive damages shall be awarded under this section unless the acts giving rise the violation occur with such frequency as to indicate a general business practice and these acts are:*

a. Willful, wanton and malicious;

b. In reckless disregard for the rights of the insured; or

c. In reckless disregard to the rights of a beneficiary under a life insurance contract."

- Are punitive damages insurable?

    - Florida public policy prohibits liability insurance for punitive damages that are directly assessed due to wrongful conduct. *See U.S. Concrete Pipe Co. v. Bould*, 437 So. 2d 1061, 1064 (Fla. 1983) ("The Florida policy of allowing punitive damages to punish and deter those guilty of aggravated misconduct would be frustrated if such damages were covered by liability insurance."); *see also Morgan Int'l Realty, Inc. v. Dade Underwriters Ins. Agency, Inc.*, 617 So. 2d 455, 459 (Fla. 3d DCA 1993).

    - However, punitive damages that are assessed due to vicarious liability are insurable in Florida. *See U.S. Concrete Pipe Co.*, 437 So. 2d at 1064 ("[I]t is generally held that there is a distinction between the actual tort-feasor and one only vicariously liable and that therefore public policy is not violated by construing a liability policy to include punitive damages recovered by an injured person where the insured did not participate in or authorize the act."); *see also Highlands Ins. Co. v. McCutchen*, 486 So. 2d 4, 4 (Fla. 3d DCA 1986).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - There are no decisions on this issue. However, the outcome may depend upon the nature of the insured's conduct that resulted in the punitive damage award against it. See above discussion of insurability of punitive damages.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

- No, absent agreement. *See Marlin v. State Farm Mut. Auto Ins.*, 761 So. 2d 380, 381 (Fla. 4th DCA 2000) ("[A]n insurer is not liable for the malpractice of the attorney it retains to defend the insured. . . . [T]he attorney retained to conduct the litigation acts in the capacity of an independent contractor, responsible for the results of his/her conduct, and is not subject to the control and direction of the insurer. Thus, because the insurer exercises no control over the attorney's performance, it is not, absent an agreement, liable for any alleged acts of professional negligence committed by the attorney." (Citing *Aetna Cas. & Sur. Co. v. Protective Nat'l Ins. Co. of Omaha*, 631 So. 2d 305, 306-08 (Fla. 3d DCA 1993), *r'hring granted in part on other grounds, and denied in part,* 631 So. 2d 305 at 308, *rev. denied*, 641 So. 2d 1346 (Fla. 1994)).

- Insurer's duties in relation to the insured are: "(1) to make immediate inquiry into the facts of any serious accident as soon as practicable after its occurrence; (2) on filing of suit against its assured to employ competent counsel to represent the assured and to provide counsel with adequate funds to conduct the defense of the suit; (3) to keep abreast of the progress and status of the litigation in order that it may act intelligently and in good faith on settlement." *See Aetna Cas. & Sur. Co. v. Protective Nat'l Ins. Co. of Omaha*, 631 So. 2d 305, 307 (Fla. 3d DCA 1993), *r'hring granted in part on other grounds, and denied in part,* 631 So. 2d 305 at 308, *rev. denied*, 641 So. 2d 1346 (Fla. 1994)).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. Section 624.155, et seq. pertaining to civil remedies as well as Section 626. Unfair Insurance Trade Practices including Section 626.9541, Unfair methods of competition and unfair or deceptive acts or practices defined. *See*, *State Farm Mut. Auto Ins. Co. v. LaForet*, 658 So.2d 55 (Fla. 1995) and *Auto Owners Insurance Company v. Conquest*, 658 So.2d 928 (Fla. 1995).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. The Florida Supreme Court first established the right of the third party to sue the tortfeasor's insurer in *Auto Mutual Indemnity Company v. Shaw*, 184 So. 852 (Fla. 1938). See, *State Farm Mut. Auto Ins. Co. v. LaForet*, 658 So.2d 55 (Fla. 1995). The Florida Supreme Court held that an insurer has a duty to act in good faith with regard to claims brought by third parties against their insureds. See also *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So.2d 783 (Fla. 1980). The common law standard for bad faith is whether the insurer breached its fiduciary duty to the insured by wrongfully refusing to defend its insured, by wrongfully refusing to settle within the policy limits or by exposing the insured to an excess judgment. *Dunn v. National Sec. Fire & Cas. Co.*, 631 So.2d 1103 (Fla. 5th DCA 1993).

- What are the applicable statutes of limitations?

    - Four years.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - An insurer has the right to deny claims that it in good faith believes are not owed on a policy. Even when it is later determined by a court that the insurer's denial was mistaken, there is no recovery for bad faith if the denial is shown to be in good faith. *Vest v. Travelers Ins. Co.*, 753 So.2d 1270 (Fla. 2000).

- What are the recoverable damages for the bad faith cause of action?

    - Damages recoverable in a third-party action include the amount of the excess judgment, direct consequential damages, costs, and attorneys' fees. Mental distress damages are generally not recoverable unless the insurer's behavior is so outrageous in character and so extreme as to go beyond the bounds of decency and be deemed intolerable in a civilized community.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes. Under a common law third party claim, the conduct which gives rise to punitive damages must constitute a separate tort. *T.D.S. v. Shelby Mut. Ins. Co.,* 760 F.2d 1520 (11th Cir. 1985). The Plaintiff must show that the settlement practice in question represents a "general business practice." In some instances, the question of whether the conduct rises to the level of a "general business practice" is for the Court. *Howell Demarest v. State Farm Mut. Auto. Ins. Co.,* 673 So.2d 526 (Fla. 4th DCA 1996).

GEORGIA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes

- Can third parties sue for bad faith (i.e., third party bad faith)? No

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute and its main provisions.

    - Yes. § 33-34-1, et seq, the "Georgia Motor Vehicle Accident Reparations Act."

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. In *Southern General Ins. Co. v. Holt*, 262 Ga. 260, 416 S.E.2d 274 (1992), the court addressed an insurer's liability for failure to settle the claim within the policy limits when faced with a time-limited settlement demand. The Supreme Court held that an insurance company "may be liable for damages to its insured for failing to settle a claim of an injured person where the insurer is guilty of negligence, fraud or bad faith in failing to compromise the claim." The insurance company must give equal consideration to the interest of the insured. The jury in general must decide whether the insurer gave the insured the same faithful consideration it gives it own interest. See also *Great Am. Ins. Co. v. Exum*, 123 Ga. App. 515, 181 S.E.2d 704 (1981).

    - Plaintiff may not sue in tort for defendant's mere breach of a duty imposed by a contract. However, if the defendant breaches a duty imposed by tort law independent of a contract and plaintiff sustains damages other than loss of benefit of the contract, plaintiff may sue in tort. *DeLance v. St. Paul Fire & Marine Ins. Co.*, 947 F.2d 1536 (1991). This includes misrepresenting the existence of extent

of coverage as well as misrepresentations in the claims handling process.

- What are the applicable statutes of limitations?

    - The statute of limitations for breaches of an insurance contract is six years. Ga. Code §9-3-24.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - To prevail on a claim for an insurer's bad faith, the insured must prove that: (1) the claim is covered under the policy, (2) a demand for payment was made against the insurer within sixty days prior to filing suit, and (3) the insurer's failure to pay was motivated by bad faith. Ga.Code Ann. §33–4–6; *BayRock Mortg. Corp. v. Chicago Title Ins. Co.*, 648 S.E.2d 433 (Ga. Ct. App. 2007). Because the damages for an insurer's bad faith failure to timely pay claim are in the nature of a penalty, the statute permitting damages is strictly construed, and the right to such recovery must be clearly shown. The insured bears the burden of proving that the refusal to pay the claim was made in bad faith. Ga.Code Ann. § 33–4–6; *Atlantic Title Ins. Co. v. Aegis Funding Corp.*, 651 S.E.2d 507 (Ga. Ct. App. 2007).

- What are the recoverable damages for the bad faith cause of action?

    - The Motor Vehicle Accident Reparations Act Allows penalties of the greater of 50% of the loss or $5000 as well as attorney fees. This is the exclusive remedy for claims which fall under the Act.

    - There is no rule against consequential damages for claims for negligent failure to settle or fraud.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Ga.Code Ann. § 33–4–6 provides that where the insurer, in bad faith, fails to pay a first party covered loss within 60 days the insured is entitled to an additional 50% or $5000.00, whichever is greater, plus attorney fees. § 33–4–7 provides the same penalty to

an auto insurer for failing to make a good faith effort to settle the claim.

- Are punitive damages insurable?

    - Yes. See *Greenwood Cemetery, Inc., v. Travelers Indem. Co*. 232 S.E.2d 970.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - No reported decision.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - There is no case on point. There is a case which may provide some guidance on the issue, *Tuzman v. Leventhal*, 174 Ga.App. 297, 329 S.E.2d 610 (Ga.App.,1985). Tuzman invested in a company. Leventhal agreed to indemnify for IRS claims. The agreement gave Leventhal the right to pick defense counsel and direct defense and settlement where Leventhal might have to indemnify Tuzman. The IRS made a settlement offer that, notwithstanding Leventhal's right to accept per the indemnity agreement, Tuzman rejected. Tuzman later settled the case and asked for Indemnification. The Georgia Court of Appeal held that the mere assertion that counsel Leventhal retained created a conflict of interest was speculative.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Yes. *Smoot v. State Farm Mut. Auto. Ins. Co*., 299 F.2d 525 (6th Cir. 1962). Those whom the Insurer selects to execute its promises, whether attorneys, physicians, no less than company-employed adjusters, are its agents for whom it has the customary legal liability.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. A third party can file suit as a judgment creditor. A third-party can take an assignment of a bad faith tort based claim. Claims for statutory penalties pursuant to OCGA § 33-4-6 may not be assigned. *Southern Gen. Ins. Co. v. Ross*, 227 Ga.App. 191, 196(7), 489 S.E.2d 53 (1997). A claim for a tort cause of action for compensatory damages for loss of property resulting from an insurer's bad-faith may be assigned. *Thomas v. American Global Ins. Co.*, 229 Ga.App. 107, 493 S.E.2d 12 (1997).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. See above.

HAWAI'I

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes

- Can third parties sue for bad faith (i.e., third party bad faith)? No

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Haw. Rev. Stat. § 431:13-103(a)(1) "Unfair methods of competition and unfair or deceptive acts or practices defined."

        - This regulatory statute does not create a private right of action against insurer for alleged violations. *Hunt v. First Ins. Co. of Hawaii, Ltd.*, 922 P.2d 976 (Haw. 1996).

    - Haw. Rev. Stat. § 480-2, "Unfair competition, practices, declared unlawful."

        - Claimant under premises medical payments coverage of CGL policy lacked standing to maintain statutory unfair practices claim against CGL insurer that denied claim because corporate policyholder was not "consumer" as required by Haw. Rev. Stat. § 480-13. *Hunt v. First Ins. Co. of Hawaii, Ltd.*, 922 P.2d 976 (Haw. 1996).

        - Workers compensation claimant lacked standing to maintain statutory unfair practices claim against workers compensation insurer because claimant's employer was not "consumer" as required by Haw. Rev. Stat. § 480-13. *Hough v. Pacific Ins. Co., Ltd.*, 927 P.2d 858 (Haw. 1996).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- Tort = YES; Contract = NO. Hawaii follows the standard set forth in *Gruenburg v. Aetna Insurance Co*. (1973) 9 Cal. 3d 566.

    - *Best Place, Inc. v. Penn Am. Ins. Co.*, 920 P.2d 334, 347 (Haw. 1996) ("We believe that the appropriate test to determine bad faith is the general standard set forth in *Gruenberg* and its progeny") (first-party fire insurance policy).

    - The tort of bad faith allows an insured to recover even if the insurer performs the express covenant to pay claims. *Best Place*, 920 P.2d at 345.

    - "Inasmuch as Enoka has alleged that AIG handled the denial of her claim for no-fault benefits in bad faith, we conclude that she is not precluded from bringing her bad faith claim even where there is no coverage liability on the underlying policy." *Enoka v. AIG Hawaii Ins. Co.*, 128 P.3d 850 (Haw. 2006).

- Workers' compensation claimant is intended third party beneficiary of employer's workers' compensation insurance contract with standing to maintain claim of bad faith against claimant's employer's workers' compensation insurer. *Hough v. Pacific Ins. Co., Ltd.*, 927 P.2d 858 (Haw. 1996); *Wittig v. Allianz, A.G.*, 145 P.3d 738 (Haw.App. 2006).

    - "An insurer's tort liability for bad faith is separate from its liability for a workers' compensation claim." *Hough*, 927 P.2d at 865-68.

- *Francis v. Lee Enterprises, Inc.*, 971 P.2d 707 (Haw. 1999) (abrogating cause of action for tortious breach of contract but distinguishing tort of bad faith in first-party context).

    - *See also Reassure Am. Life Ins. Co. v. Rogers*, 248 F. Supp. 2d 974, 986-87 (D. Haw. 2003) ("The insured must establish that the insurer 'unreasonably acted without proper cause.'")

- What are the applicable statutes of limitations?

- Two-year limitation period in third-party auto cases. *Honbo v. Hawaiian Ins. & Guar. Co., Ltd.*, 949 P.2d 213 (Haw.App. 1997) (applying former Haw. Rev. Stat. § 294-36(a)); Haw. Rev. Stat. § 431:10C-315.

- Two-year limitation period in first-party property insurance cases. *Christiansen v. First Ins. Co. of Hawaii, Ltd.*, 967 P.2d 639 (Haw.App. 1998) (applying Haw. Rev. Stat. § 657-7)).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - "Conduct based on an interpretation of the insurance contract that is reasonable does not constitute bad faith." *Best Place, Inc. v. Penn. America Ins. Co.*, 920 P.2d 334, 347 (Haw. 1996) (*citing California Shoppers Inc. v. Royal Globe Ins. Co.*, 175 Cal.App.3d 1, 221 Cal.Rptr. 171 (1985)).

    - "Genuine dispute of fact" defense probably also available since Hawai'i follows *Gruenberg*.

  - Denial of first-party claim based upon open question of law was not in bad faith. *Enoka*, 128 P.3d at 866.

  - Workers' compensation insurer's offer to settle injured worker's compensation claim on terms that required worker to resign employment in exchange for payment of additional consideration did not constitute bad faith. *Wittig v. Allianz, A.G.*, 145 P.3d 738 (Haw.App. 2006).

  - Workers' compensation insurer does not owe duty of good faith and fair dealing to claimant's health care provider. *Jou v. National Interstate Ins. Co. of Hawaii*, 157 P.3d 561 (Haw.App. 2007).

  - Auto insurer does not owe duty of good faith and fair dealing under personal injury protection coverage to insured's health care provider. *Jou v. Dai-Tokyo Royal State Ins. Co.*, 172 P.3d 471 (Haw. 2007).

- Hawai'i Insurance Guaranty Association is statutorily immune from liability for bad faith. Haw. Rev. Stat. § 431:16-116. *Mendes v. Hawai'i Ins. Guar. Ass'n*, 950 P.2d 1214 (Haw. 1998)

- Potential liability for bad faith requires underlying contract of insurance. *Willis v. Swain*, 126 Hawai'i 312, 270 P.3d 1042 (App. 2012) (JUP insured has no claim for bad faith against assigned risk insurer); *Simmons v. Puu*, 105 Hawai'i 112, 94 P.3d 667 (2004) (renter has no claim for bad faith against self-insured car rental company).

- What are the recoverable damages for the bad faith cause of action?

  - Tort damages including emotional distress from financial loss, since Hawaii follows *Gruenburg v. Aetna Insurance Co*. (1973)9 Cal. 3d 566

  - Insured's claim against liability insurer for general damages based on bad faith is not assignable. *Sprague v. California Pacific Bankers & Ins. Ltd.*, 74 P.3d 12 (Haw. 2003).

  - If a first-party insurer commits bad faith, an insured need not prove the insured suffered economic or physical loss caused by the bad faith in order to recover emotional distress damages caused by the bad faith. *Miller v. Hartford Life Ins. Co.*, 126 Hawai'i 165, 268 P.3d 418 (2011).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Punitive damages may not be awarded in a bad faith tort case unless the evidence reflects "something more" than the conduct necessary to establish the tort. *Best Place, Inc. v. Penn Am. Ins. Co.*, 920 P.2d 334 (Haw. 1996). They may only be awarded if plaintiff proves by clear and convincing evidence that "the defendant has acted wantonly or oppressively or with such malice as implies a spirit of mischief or criminal indifference or where there has been wilful misconduct or that entire want of care which would raise the presumption of conscious indifference to consequences." *Id.* at 348.

- Haw. Rev. Stat. Ann. § 663-1.2: *Tort liability for breach of contract; punitive damages. No person may recover damages, including punitive damages, in tort for a breach of a contract in the absence of conduct that:*

  (1) Violated a duty that is independently recognized by principles of tort law; and

  (2) Transcended the breach of the contract.

- Are punitive damages insurable?
  - Punitive damages are not covered by insurance policies. *See, Francis v. Lee Enterprises, Inc.*, 971 P.2d 707 (Haw. 1999).Haw. Rev. Stat. Ann. §431:10-240: *"Insurance contracts; punitive damages…Coverage under any policy of insurance issued in this State shall not be construed to provide coverage for punitive or exemplary damages unless specifically included."*

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - This issue has not been addressed by any Hawaii reported appellate decision.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - No, *Cumis* was specifically rejected in *Finley v. Home Ins. Co*., 975 P.2d 1145 (Haw. 1998). The court held that "the best result is to refrain from interfering with the insurer's contractual right to select counsel and leave the resolution of the conflict to the integrity of retained defense counsel," and professional standards of conduct.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

  - This issue has not been addressed by any Hawaii reported appellate decision.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - *Best Place, Inc. v. Penn Am. Ins. Co.*, 920 P.2d 334, 346 (Haw. 1996) ("there is a legal duty, implied in a first- and third-party insurance contract, that the insurer must act in good faith in dealing with its insured, and a breach of that duty of good faith gives rise to an independent tort cause of action.").

        - "We note that in the context of suits against an insurer for bad faith refusal to settle a third-party claim, courts [of other jurisdictions] have concluded that the plaintiff must show that the third-party claimant extended a reasonable settlement offer which the insurer then rejected. *Wittig*, 145 P.3d at 751 (citations omitted).

    - *Honbo v. Hawaiian Ins. & Guar. Co., Ltd.*, 949 P.2d 213 (Haw.App. 1997)

    - Liability insurer does not owe duty of good faith and fair dealing to tort claimant. *Young v. Allstate Ins. Co.*, 198 P.3d 666, 691 (Haw. 2008) ("Absent a contract and because Young's claim [for bad faith against Allstate] was premised upon the existence of a contract, her claim for breach of the assumed duty of good faith and fair dealing must fail.").

IDAHO

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. Idaho's Unfair Claims Settlement Practices Act, Idaho Code § 41-1329 (2009), does not give rise to a private right of action whereby an insured can sue the insurer for statutory violations committed in connection with the settlement of the insured's claim. *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 96, 730 P.2d 1014 (Idaho 1986). Evidence of violations of the Unfair Claims Settlement Practices Act is admissible to show violation of insurance industry standards. *Weinstein v. Prudential Prop. & Cas. Ins. Co.*, 149 Idaho 299, 233 P.3d 1221 (2010).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes.

    - *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (Idaho 1986).

        - "[W]here an insurer intentionally and unreasonably denies or delays payment on a claim, and in the process harms the claimant in such a way not fully compensable at contract, the claimant can bring an action in tort to recovery for the harm done." *Id.* at 98.

- *Robinson v. State Farm Mut. Auto. Ins. Co.*, 137 Idaho 173, 45 P.3d 829 (Idaho 2002).

    - The insured bears the burden of proving all elements of a bad faith claim against the insurer by a preponderance of the evidence. *Id.* at 176.

    - To prevail on a bad faith claim, the insured must show: "1) the insurer intentionally and unreasonably denied or withheld payment; 2) the claim was not fairly debatable; 3) the denial or failure to pay was not the result of a good faith mistake; and 4) the resulting harm is not fully compensable by contract damages." *Id.* (citing *White, supra*).

- *Truck Ins. Exch. v. Bishara*, 128 Idaho 550, 916 P.2d 1275 (Idaho 1996).

    - In the liability insurance context: "An insurer is under a duty to exercise good faith in considering offers to compromise an injured party's claim against the insured for an amount within the insured's policy limits." *Id.* at 553

    - The court will apply an "equality of consideration" test that requires the insurer to give equal consideration to the interests of its insured when deciding whether to accept a settlement offer. *Id.* at 554.

    - The "equality of consideration" test requires the court to take into account seven factors, placing emphasis on two factors. The two important factors are (1) "whether the insurer has failed to communicate with the insured, including particularly informing the insured of any compromise offers," and (2) "the amount of financial risk to which each of the parties will be exposed in the event an offer is refused." *Id.* at 555.

    - The remaining five factors to be considered are "the strength of the injured claimant's case on the issues of liability and damages; whether the insurer has thoroughly investigated the claim; the failure of the insurer to follow the legal advice

of its own attorney; any misrepresentations by the insured which have misled the insurer in its settlement negotiations; and any other factors which may weigh toward establishing or negating the bad faith of the insurer." *Id.*

- What are the applicable statutes of limitations?

    - Tort claims must be brought within two years. Idaho Code § 5-219(4).

    - Actions for breach of contract must be brought within five years. Idaho Code § 5-216.

    - Idaho statutes also provide that contract terms limiting the time in which a party may enforce his or her rights is void. Idaho Code § 29-110.

        - The Supreme Court of Idaho has held that these statutes trump the suit limitation provision in an insurance contract, despite Idaho's adoption of the standard New York fire insurance policy, which contains a one-year suit limitation provision. *Sunshine Mining Co. v. Allendale Mut. Ins. Co.*, 107 Idaho 25, 28, 684 P.2d 1002 (1984).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - The claim must be covered under the policy before a bad faith claim can apply. *Robinson v. State Farm Mut. Auto. Ins. Co.*, 137 Idaho 173, 45 P.3d 829 (Idaho 2002).

    - "An insurer does not act in bad faith when it challenges the validity of a 'fairly debatable' claim, or when its delay results from honest mistakes." *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (Idaho 1986).

- What are the recoverable damages for the bad faith cause of action?

- An insured may recover damages normally available in tort. *Walston v. Monumental Life Ins. Co.*, 129 Idaho 211, 219, 923 P.2d 456 (1996).

- Damages in tort are not limited to damages that were foreseeable at the time of the tortious act. "[R]ather they include a reasonable amount which will compensate plaintiff for *all* actual detriment proximately caused by the defendant's wrongful conduct." *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (Idaho 1986).

- Emotional distress damages may be recovered if the insured proves the elements of a claim for intentional infliction of emotional distress. *Roper v. State Farm Mut. Auto. Ins. Co.*, 131 Idaho 459, 463, 958 P.2d 1145 (Idaho 1998).

- Attorney's fees may be recoverable. Idaho Code §§ 41-1839 and 12-123 provide the exclusive remedy for obtaining attorney's fees in disputes arising out of insurance policies. Attorney's fees shall be awarded to the insured if the insurer fails to pay the amount justly due under the policy within 30 days after proof of loss. In addition, attorney's fees may be awarded to either party if the other party brought, pursued, or defended a claim frivolously, unreasonably, or without foundation. Idaho Code § 41-1839(4).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. *Walston v. Monumental Life Ins. Co.*, 129 Idaho 211, 219, 923 P.2d 456 (1996).

  - "In any action seeking recovery of punitive damages, the claimant must prove, by clear and convincing evidence, oppressive, fraudulent, malicious or outrageous conduct by the party against whom the claim for punitive damages is asserted." Idaho Code § 6-1604(1).

  - Recovery of punitive damages against an insurer, like other corporations, requires evidence that "an officer or director participated in, or ratified, the conduct constituting bad faith."

Weinstein v. Prudential Prop. & Cas. Ins. Co., 149 Idaho 299, 233 P.3d 1221 (Idaho 2010)

- Punitive damages are limited by statute to the greater of $250,000 or three times the amount of compensatory damages contained in the judgment. Idaho Code 6-1604(3).

- Are punitive damages insurable?

  - Yes. Punitive damages are insurable and will fall within the coverage afforded by a policy unless specifically excluded. *Abbi Uriguen Oldsmobile Buick, Inc. v. U.S. Fire Ins. Co.*, 95 Idaho 501, 511 P.2d 783 (Idaho 1973).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - It appears likely that an Idaho court would allow such damages to be recovered by the insured. "In a third party action where the insurer unreasonably denies a settlement or payment, the insured would be able to recover contract damages up to the policy limits and then tort damages for any excess." *McKinley v. Guaranty Nat. Ins. Co.*, 144 Idaho 247, 252, 159 P.3d 884, 890 (Idaho 2007).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - Yes. Idaho follows a similar rule, set forth in *Boise Motor Car Co. v. St. Paul Mercury Indem. Co.*, 62 Idaho 438, 449, 112 P.2d 1011 (Idaho 1941). When the insured does not consent to the insurer defending under a reservation of rights, the insured is entitled to retain independent counsel at the insurer's expense.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

  - This has not yet been addressed in Idaho.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. Idaho's Unfair Claims Settlement Practices Act, Idaho Code § 41-1329 (2009), does not give rise to a private right of action. *White v. Unigard Mut. Ins. Co.*, 112 Idaho 94, 730 P.2d 1014 (Idaho 1986).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. A third party may not bring a bad faith claim against the tortfeasor's insurer "in the absence of specific authorization to that effect." *Hettwer v. Farmers Ins. Co.*, 118 Idaho 373, 374, 797 P.2d 81 (Idaho 1990); *see also Graham v. State Farm Mut. Auto. Ins. Co.*, 138 Idaho 611, 67 P.3d 90 (Idaho 2003).

ILLINOIS

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No, third parties cannot sue another's insurer directly for bad faith.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (*i.e.*, an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. There are two different statutory grounds in Illinois.

    - 215 ILCS §5/155 provides a remedy to policyholders or assignees when an insurer's refusal to recognize liability and pay a claim is vexatious and unreasonable:

      "*In any action by or against a company wherein there is in issue the liability of a company on a policy or policies of insurance or the amount of the loss payable thereunder, or for an unreasonable delay in settling a claim, and it appears to the court that such action or delay is vexatious and unreasonable, the court may allow as part of the taxable costs in the action reasonable attorney fees, plus an amount not to exceed any one of the following amounts:*

      (a) 60% of the amount which the court or jury finds such party is entitled to recover against the company, exclusive of all costs;

      (b) $60,000;

      (c) The excess of the amount which the court or jury finds such party is entitled to recover, exclusive of costs, over the amount, if any, which the company offered to pay in settlement of the claim prior to the action.

      Where there are several policies insuring the same insured against the same loss whether issued by the same or by different companies, the court may fix the amount of the allowance so that the total attorney fees on

account of one loss shall not be increased by reason of the fact that the insured brings separate suits on such policies."

- Factors to be considered in deciding liability under Section 155 include the attitude of the insurer, whether the insured was forced to sue to recover, and whether the insured was deprived of the use of its property for any length of time. *Gaston v. Founders Ins. Co.*, 365 Ill. App. 3d 303, 847 N.E.2d 523 (1st Dist. 2006). The acts of an insurer's agent such as an appraiser or third-party administrator may also constitute unreasonable and vexatious conduct that can be attributed to an insurance company. *McGee v. State Farm Fire and Cas. Co.*, 315 Ill. App. 3d 673, 734 N.E.2d 144, 151 (2d Dist. 2000).

- Conduct that constitutes a violation of Section 155.

    - Failing to communicate promptly, regularly or truthfully with an insured. *Employers Ins. of Wausau v. Ehlco Liquidating Trust*, 186 Ill. 2d 127, 708 N.E.2d 1122 (1999).

    - Failing to pay either all or the portion of claim the insurer acknowledges is due in a timely manner. *Valdovinos v. Gallant Ins. Co.*, 314 Ill. App. 3d, 733 N.E.2d 886 (2d Dist. 2000).

    - Forcing an insured to litigate to obtain his or her benefits. *Buais v. Safeway Ins. Co.*, 275 Ill. App. 2d 587, 656 N.E.2d 61 (1st Dist. 1995).

    - Failing to properly investigate a claim and/or basing a denial on improper investigative grounds. *Norman v. Am. National Ins. Co.*, 198 Ill. App. 3d 269, 555 N.E.2d 1087 (5th Dist. 1990).

    - Engaging in one of the improper claims practices outlined in the Illinois Insurance Code. Section 154.6 of the Insurance Code describes 18 acts that constitute improper claims practices. 215 ILCS §5/154.6. Violations of 50 Ill. Adm. Code §919.50 can also serve

as evidence of bad faith. Currently, a violation of these Sections does not alone state a cause of action. *American Service Ins. Co. v. Passarelli*, 323 Ill. App. 3d 587, 752 N.E.2d 635 (1st Dist. 2001).

- Finally, an insured can also sue an insurer for its post-claim behavior under the Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1, et seq. Insurers can be held liable under the Act for deception in the adjustment of a claim. *Elder v. Coronet Ins. Co.*, 201 Ill. App. 3d 733, 558 N.E.2d 1312 (1st Dist. 1990); *P.I.A. Michigan City, Inc. v. National Porges Radiator Corp.*, 789 F. Supp. 1421 (N.D. Ill. 1992). An injured third-party claimant cannot state a statutory consumer fraud claim against an insurer based on its claims practices because, in that context, the injured plaintiff is not a "consumer" and, therefore, has no standing to sue under the Act. *McCarter*, 473 N.E.2d 1015.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? Sort of. If so, identify the major cases(s) and language of the standards applicable to bad faith cases.

  - While there is no common law "bad faith" tort action under Illinois law, an insured may assert a common-law action against a liability insurer that has failed to act in good faith in responding to a settlement offer. *Cramer v. Ins. Exchange Agency*, 174 Ill. 2d 513, 675 N.E.2d 897 (1996). The duty to settle does not arise until there is a *reasonable probability* of (1) recovery in excess of policy limits and (2) a finding of liability against the insured. *Chandler v. American Fire and Cas. Co.*, 377 Ill. App. 3d 253, 879 N.E.2d 396 (4th Dist. 2007). Moreover, the duty does not arise until a third party demands settlement within the policy limits. *Haddick v. Valor Ins.*, 198 Ill. 2d 409, 763 N.E.2d 299 (2001).

  - In determining whether an insurer has breached the duty to settle, Illinois courts consider (1) whether the insurer ignored the advice of its own claims adjusters, (2) whether the insurer refused to engage in settlement negotiations; (3) whether the insurer ignored the settlement recommendations of the insured's defense counsel, (4) whether the insurer kept the insured aware of the third party's willingness to settle; (5) whether the insurer conducted an adequate

investigation and defense; (6) whether a substantial prospect of an adverse verdict existed; and (7) whether there was a potential for damages to exceed the policy limits. *O'Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166, 769 N.E.2d 100 (5th Dist. 2002). An insurer does not breach a duty to settle when it rejects a settlement offer made after entry of an excess judgment or if it offers to settle and the offer is refused for no reason.

- What are the applicable statutes of limitations?

    - The statute of limitations for a Section 155 bad-faith claim is five years. 735 ILCS §5/13-202.

    - The statute of limitations for a Consumer Fraud Act bad-faith claim is three years. 815 ILCS 505/10a(e).

    - The statute of limitations for a common-law "duty to settle" claim is five years. 735 ILCS §5/13-202.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - With regard to a statutory claim, when there is a *bona fide* dispute as to whether a policy provides coverage for a claim, an insurer's delay in processing or denial of a claim will not be considered a violation of Section 155. *State Farm Mut. Auto. Ins. Co. v. Smith*, 197 Ill. 2d 369, 757 N.E.2d 881 (2001). A *bona fide* dispute exists where (1) there is a genuine dispute over the scope and application of insurance coverage; (2) the insurer asserts a legitimate policy defense; (3) the claim presents a genuine factual issue impacting coverage; or (4) the insured takes a reasonable legal position based on an unsettled issue of law. *General Star Indemnity Co. v. Lake Bluff School District 65*, 354 Ill. App. 3d 118, 819 N.E.2d 784 (2d Dist. 2004).

    - If no coverage is owed under a policy, an insurer cannot be held liable for statutory or common-law damages regardless of their post-claim conduct. *Zubi v. Acceptance Indemnity Ins. Co.*, 323 Ill. App. 3d 28, 751 N.E.2d 69 (1st Dist. 2001); *Stevenson v. State Farm*

Fire & Casualty Co., 257 Ill. App. 3d 179, 628 N.E.2d 810 (1st Dist. 1993).

- What are the recoverable damages for the bad faith cause of action?

    - Damages, beyond straight compensatory, available for Section 155 statutory bad faith include:

        - Penalties: The statutory penalty is currently capped at $60,000. Subparagraphs a and c of Section 155 provide a formula for calculating the penalty award where, for example, the court has determined that a penalty of $60,000 is excessive.

        - Attorneys' fees: The only cap on the amount of attorneys' fees is the language in the statute requiring that they be "reasonable." The allowance of and the amount of any fees are decisions resting in the discretion of the court.

        - Costs: "[O]ther costs" is not defined by the statute. Courts give the term a broad interpretation with the goal of placing the insured in as good a position as he would have been had the insurer paid the value of the claim when requested. *Watson v. State Farm Fire & Casualty Co.*, 122 Ill. App. 3d 559, 461 N.E.2d 57 (3d Dist. 1984).

        - Prejudgment interest: If an amount is liquidated or capable of easy calculation, prejudgment interest can also be recovered with respect to Section 155 claims. *Millers Mut. Ins. Co.*, 675 N.E.2d 1037.

    - For a violation of the Illinois Consumer Fraud Act, insureds can recover "actual economic damages or any other relief which the court deems proper," "reasonable attorney's fees and costs to the prevailing party" and punitive damages. 815 ILCS 505/10(a and c); *Smith v. Prime Cable of Chicago*, 276 Ill. App. 3d 843, 658 N.E.2d 1325 (1st Dist. 1995).

- If successful in proving a failure to settle or common-law bad faith claim, a plaintiff can recover the full amount of any excess judgment, attorneys' fees and possibly punitive damages.

- Are punitive damages recoverable? Yes. If so, what is the standard that must be met to recover them?

  - With regard to a common-law or failure to settle bad faith claim, an insurer may be liable for punitive damages if the insurer's failure to settle is a result of conduct that exceeds mere negligence. *O'Neill*, 769 N.E.2d 100 (holding that punitive damages could be imposed on insurer who acted with "utter indifference and reckless disregard for its policyholder's financial welfare" in its failure to settle within policy limits).

- Does the state follow the *Cumis* case (*i.e.,* require independent counsel when there is an insurer-insured conflict)?

  - The Supreme Court of Illinois, in the seminal case of *Maryland Casualty Company v. Peppers*, 64 Ill. 2d 187, 355 N.E.2d 24 (1976), held that attorneys engaged by an insurance company to represent an insured of that company have an obligation to notify their client, the insured, of any potential conflict of interest and make full disclosure to the client of the conflict of interest. Where a conflict of interests between an insurer and an insured potentially exists, an insured has the option of accepting the defense furnished by the attorneys retained by the insurance company after full disclosure of the conflict of interest. If the insured elects not to accept the defense, the insured has a right to be defended in the action brought against her by an attorney of her own choice who shall have the right to control the conduct of the case which pertains to those allegations directed against the insured. The Illinois Supreme Court has further held that under those circumstances the insurance company must reimburse the insured for the reasonable costs of defending the action.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (*i.e.*, an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No, there is no statutory third-party bad faith.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No, in general a third party claimant has no direct action against the insurer for bad faith. *Scroggins v. Allstate Ins. Co.*, 74 Ill. App. 3d 1027 (1979).

    - However, the Illinois Supreme Court has held that where a plaintiff can properly allege and prove the elements of a separate tort for insurer misconduct (something other than an unreasonable and vexatious delay in settling the claim), an insured or third party will be allowed to pursue that cause of action against the insurer. *Cramer v. Ins. Exchange Agency*, 174 Ill. 2d 513, 675 N.E.2d 897 (1996). Such additional tort theories include claims for fraud or intentional infliction of emotional distress, and a claim for consumer fraud pursuant to *McCarter v. State Farm Mutual Auto. Ins. Co.*, 130 Ill. App. 3d 97, 473 N.E.2d 1015 (3d Dist. 1985); *Tobolt v. Allstate Ins. Co.*, 75 Ill. App. 3d 57, 393 N.E.2d 1171 (1st Dist. 1979). Mere allegations of bad faith or vexatious and unreasonable conduct are insufficient to state a claim for an independent tort. *Cramer*, 675 N.E.2d 897.

        - An insurer may be found to have committed common-law fraud and may thereby be exposed to extra-contractual damages if it makes misrepresentations to injured third parties in connection with processing claims or settlement negotiations. *McCarter v. State Farm Mutual Auto. Ins. Co.*, 130 Ill. App. 3d 97, 473 N.E.2d 1015 (3d Dist. 1985).

        - A cause of action for intentional infliction of emotional distress is an extremely difficult cause of action to prove since, except in extreme cases, plaintiffs in bad faith cases often have trouble proving that the insurer's conduct was

outrageous, that the plaintiff's distress was severe, or that the insurance company intended to cause the distress. *Tobolt v. Allstate Ins. Co.*, 75 Ill. App. 3d 57, 393 N.E.2d 1171 (1st Dist. 1979).

- Additionally, failure to settle claims are not limited to insured versus insurer situations. Primary insurers owe a duty to excess insurers to act reasonably and in good faith in attempting to settle the underlying claim within their policy limits. *Shal Bovis, Inc. v. Casualty Ins. Co.*, 314 Ill. App. 3d 562, 732 N.E.2d 1082 (1st Dist. 1999). At least one Illinois court has also found that an excess insurer can owe another excess insurer the duty to settle a claim. *Central Illinois Public Service Co. v. Agricultural Ins.* Co., 378 Ill. App. 3d 728, 880 N.E.2d 117, 172 (5th Dist. 2008).

- What are the recoverable damages for the bad faith cause of action?

  - Generally, the measure of damages for fraud is such an amount as will compensate the plaintiff for the loss occasioned by the fraud, or, in simpler terms, the amount which plaintiff is actually out of pocket by reason of the transaction. *Martin v. Allstate Ins. Co.*, 92 Ill. App. 3d 829, 416 N.E.2d 347 (1st Dist. 1981).

  - If successful in proving a failure to settle or common-law bad faith claim, a plaintiff can recover the full amount of any excess judgment, attorneys' fees and possibly punitive damages.

INDIANA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No. *Eichler v. Scott Pools, Inc.*, 513 N.E.2d 665 (Ind. Ct. App. 1987), but insureds may assign.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - There are no statutory grounds for the bad faith cause of action outside of the worker compensation context.

    - Unfair claim settlement practices are regulated under Ind. Code § 27-4-1-4.5.

    - Unfair deceptive consumer practices are regulated by Ind. Code Ann. § 27-4-1-4.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515 (Ind. 1993).

        - There is a legal duty for insurance carriers to deal in good faith, which is implied into insurance contracts as a matter of law.

        - Tort of breach of good faith occurs when an insurer denies liability knowing that there is no "rational, principled basis for doing so." *Id.* at 520.

- *Freidline v. Shelby Ins. Co.*, 774 N.E.2d 37, 40 (Ind. 2002).
    - "[A]n insurer that denies liability knowing there is no rational, principled basis for doing so has breached its duty. [Citation omitted.] To prove bad faith, the plaintiff must establish, with clear and convincing evidence, that the insurer had knowledge that there was no legitimate basis for denying liability."
- *Patel v. United Fire & Cas. Co.*, 80 F.Supp.2d 948 (N.D. Ind. 2000).
    - To establish bad faith the policyholder must establish "dishonest purpose, moral obliquity, furtive design or ill will."
- *Country Mutual Ins. Co. v. Hunter*, 472 N.E.2d 1265 (Ind. Ct. App. 1985).
    - An insurer acts in bad faith if it denies liability and lacks a rational basis for doing so.
- *Monroe Guar. Ins. Co. v. Magwerks Corp.*, 829 N.E.2d 968 (Ind. 2005)
    - A good faith dispute concerning insurance coverage does not automatically preclude a punitive damages claim for bad faith when claim handling issues are also involved.

- What are the applicable statutes of limitations?
    - 6 years for fraud actions
    - 10 years for written contracts and actions otherwise not covered by statute. 22A INPRAC § 39.1.
    - 2 years generally for bad faith claims. *Del Vecchio v. Conseco, Inc.*, 788 N.E.2d 446 (Ind. Ct. App. 2003).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Rational, principled basis for position. *Freidline v. Shelby Ins. Co.*, 774 N.E.2d 37, 42 (Ind. 2002) (relying on pollution exclusion, though erroneous, was not bad faith).

    - Advice of counsel. *See e.g.*, *Worth v. Tamarack v. American*, 47 F. Supp.2d 1087 (S.D. Ind. 1999), *aff'd*, 201 F.3d 377 (7th Cir. 2000); *Heritage Mut. Ins. Co. v. Advanced Polymer Tech.*, 97 F. Supp.2d 913 (S.D. Ind. 2000).

    - The right to disagree. An insurer has the right to reasonably disagree with its insured in good faith. *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 520 (Ind. 1993).

    - Reverse bad faith. No Indiana appellate court has addressed this issue. *But see Willis Corroon Corp. v. Home Ins. Co.*, 203 F.3d 449, 453 (7th Cir. 2000) (stating that it is a "very doubtful assumption" that a reverse bad faith cause of action exists).

- What are the recoverable damages for the bad faith cause of action?

    - Consequential damages are recoverable in excess of policy limits whether the breach was in good or bad faith. *See Ind. Ins. Co. v. Plummer Power Mower*, 590 N.E.2d 1085 (Ind. Ct. App. 1992).

    - Damages for emotional distress are recoverable. *See Schmizzi v. Ill. Ins. Co.*, 928 F. Supp. 760 (N.D. Ind. 1996).

    - Attorneys' fees are not allowable in the absence of a statute or some agreement or stipulation authorizing such an award. *Liberty Mut. Ins. Co. v. OSI Industries, Inc.* (Ind. Ct. App. 2005) 831 N.E.2d 192, 205; *Ind. Ins. Co. v. Plummer Power Mower*, 590 N.E.2d 1085 (Ind. Ct. App. 1992). But see *American Family Mut. Ins. Co. v. Jeffrey*, 1999 WL 1893258 (S.D. Ind., Apr. 8, 1999, IP 98-1085-C H/G) (attorneys' fees might be recovered by the insured if it proves the insurer's bad faith by clear and convincing evidence).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Punitive damages may be allowed on a tort-based theory, but are generally not allowed for breach of contract.

    - The standard for punitive damages is "clear and convincing evidence" that the insurer acted with "malice, fraud, gross negligence or oppressiveness which was not the result of mistake of fact or law, honest error or judgment, over-zealousness, mere negligence or other human failing." *Erie*, 622 N.E.2d at 520; *see also Craft v. Economy Fire & Cas. Co.*, 572 F.2d 565 (C.A.Ind. 1978).

- Are punitive damages insurable?

    - No Indiana case addressing this issue has been found.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - No Indiana case addressing this issue has been found.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No Indiana case addressing this issue has been found.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No, Indiana does not permit direct suits against insurers by third parties, nor does it permit involuntary assignments of claims against carriers. However, insureds may still voluntarily assign their claims to a third party. *State Farm Mut. Auto. Ins. Co. v. Estep*, 873 N.E.2d 1021 (Ind. 2007).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No, see above.

IOWA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? Yes, but only in limited circumstances.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., and Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - There are no statutory grounds for the bad faith cause of action in Iowa.

    - Unfair claims handling by insurers is regulated by Iowa Code § 507B.4.

        - The Iowa Supreme Court has held Iowa Code chapter 507B does not create a private cause of action for an insured against an insurer. *Seeman v. Liberty Mut. Ins. Co.*, 322 N.W.2d 35, 36 (Iowa 1982).

        - Iowa Federal Courts have held, however, allegations "of unfair claims settlement practices in violation of Iowa law" may be used as evidence of an insurer's bad faith or support an award of punitive damages. *Terra Industries, Inc. v. Commonwealth Ins. Co. of America*, 990 F. Supp. 679, 688 (N.D. Iowa 1997).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes, there is a judicially created cause of action for first party bad faith in Iowa.

        - The Supreme Court of Iowa has recognized first party bad faith causes of action in tort against an insurer. *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790 (Iowa 1994).

        - In Iowa, a "first-party suit . . . is a cause of action against an insurer for bad faith failure to pay its own insured." *Kelly v. State Farm Mut. Auto. Ins. Co.*, 764 F. Supp. 1337, 1340 (S.D. Iowa 1991).

    - To establish a claim for first party bad faith, the insured must prove two facts:

        (1) That the insurer had no reasonable basis for denying benefits under the policy, and;

        (2) That the insurer knew, or had reason to know, that its denial was without basis. *Kiner v. Reliance Ins. Co.*, 463 N.W.2d 9, 12 (Iowa 1990); *Sampson v. American Standard Ins. Co.*, 582 N.W.2d 146, 149 (Iowa 1998); *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790, 794 (Iowa 1988).

    - The first element is objective; the second element is subjective. *Brown v. Danish Mut. Ins. Ass'n*, 550 N.W.2d 171, 175 (Iowa Ct. App. 1996) (citing *Reuter v. State Farm Mut. Auto. Ins. Co.*, 469 N.W.2d 250, 253 (Iowa 1991)).

- What are the applicable statutes of limitations?

    - 5 years for "all other actions not otherwise provided for." I.C.A. § 614.1(4).

    - *Cf. Zimmer v. Travelers Ins. Co.*, 454 F. Supp. 2d 839, 854–55 (S.D. Iowa 2006) ("A first party bad faith claim must be filed within five years of the date of denial by the workers' compensation carrier of the claim."); *Brown v. Liberty Mut. Ins. Co.*, 513 N.W.2d 762, 765 (Iowa 1994) ("…we hold that the five-year limitation period of section 614.1(4) applies to actions based on the bad-faith nonpayment of workers' compensation benefits.").

- "It follows, therefore, that section 614.1(4), which provides a five year statute of limitations for actions founded on 'unwritten contracts,' is the appropriate statute of limitations for an action based on an insurer's breach of a good faith duty to defend an insured against third party claimants." *Sandbulte v. Farm Bureau Mut. Ins. Co.*, 343 N.W.2d 457, 462 (Iowa 1984), *abrogated on other grounds by Merriam v. Farm Bureau Ins.*, 793 N.W.2d 520 (Iowa 2011). *Sandbulte*, however, is limited in that it involved a specific good faith duty to defend an insured and not a general implied covenant of good faith and fair dealing. *See World Plan Executive Council-U.S. v. Zurich Ins. Co.*, 810 F. Supp. 1042, 1045 (S.D. Iowa 1992)

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Defenses are available when a claim is fairly debatable.

    - A claim is fairly debatable when it is "open to dispute on any logical basis." *Bellville v. Farm Mut. Bur. Ins. Co.*, 702 N.W.2d 468, 472 (Iowa 2005).

    - "Where an insurance claim is 'fairly debatable' the bad faith claim must fail." *Stahl v. Preston Mut. Ins. Ass'n*, 517 N.W.2d 201, 203 (Iowa 1994).

    - "When considering first party bad faith claims, we have consistently stated that were a claim is 'fairly debatable,' the insurer is entitled to debate it." *Reuter v. State Farm Mut. Auto. Ins. Co.*, 469 N.W.2d 250, 253 (Iowa 1991).

    - When an objective, reasonable basis exists for an insurer to deny a claim, "the insurer as a matter of law cannot be held liable for bad faith." *Sampson v. American Standard Ins. Co.*, 582 N.W.2d 146, 150 (Iowa 1998); *Reuter v. State Farm Mut. Auto. Ins. Co.*, 469 N.W.2d 250, 254 (Iowa 1991) (explaining insurers are not liable if they had an "objectively reasonable" basis for disputing coverage).

- "The insurer's 'subpar' investigation cannot in and of itself sustain a tort action for bad faith." *Reuter v. State Farm Mut. Auto. Ins. Co.*, 469 N.W.2d 250, 254 (Iowa 1991).

- What are the recoverable damages for the bad faith cause of action?

  - Iowa Courts allow juries to award damages for emotional distress and economic loss resulting from conduct found to be in bad faith. *Nassen v. National States Ins. Co.*, 494 N.W.2d 231, 237 (Iowa 1992) (finding the plaintiff's situation was capable of producing severe mental suffering and thus the evidence was sufficient to support an award for emotional distress); *see also Gibson v. ITT Hartford Ins. Co.*, 621 N.W.2d 388 (Iowa 2001).

  - Federal Courts have held that under Iowa law, damages for emotional distress are available to insureds as consequential damages against the insurer when such insurer has failed to exercise good faith in representing the insured against a third party. *Berglund v. State Farm Mutual Auto. Ins. Co.*, 121 F.3d 1225, 1229 (8th Cir. 1997).

  - Attorney's fees can be awarded when the insurer is under a contractual obligation to defend a third party action against its insured. *Clark-Peterson Co., Inc., v. Indep. Ins. Assoc., LTD.*, 514 N.W.2d 912, 915 (Iowa 1994) (citing *N.H. Ins. Co. v. Christy*, 200 N.W.2d 834, 845 (Iowa 1972)) (finding the express terms of the policy to include the right and duty to defend suit against the insured for personal injury damages).

  - The Iowa Supreme Court has further held "there shall be no 'award for expenses incurred in an action to establish insurance coverage unless there is a showing made in the declaratory judgment action that the insurance company has acted in 'bad faith or fraudulently or was stubbornly litigious.'" *Clark-Peterson Co., Inc., v. Indep. Ins. Assoc., LTD.*, 514 N.W.2d 912, 915–16 (quoting *Christy*, 200 N.W.2d at 845).

  - Iowa Federal Courts have stated, generally, attorney's fees can only be recovered under a contract or pursuant to a statute. *Am. Family Mut. Ins. Co. v. Miell*, 569 F. Supp. 841, 859 (N.D. Iowa 2008). While

the court found there is a rare exception to this general rule, "[t]he standard for awarding common law attorney fees is distinct from, **and greater than**, the standard for awarding punitive damages." *Id.* (emphasis added) (requiring a showing of conduct that is greater than willful and wanton disregard for the rights of others; conduct amounting to "oppression or connivance to harass or injure another" (citation omitted)).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes. The standard for punitive damages is "[w]hether, by a preponderance of clear, convincing, and satisfactory evidence, the conduct of the defendant from which the claim arose constituted willful and wanton disregard for the rights or safety of another." Iowa Code Ann. § 668A.1(a); *see also Gibson v. ITT Hartford Ins. Co.*, 621 N.W.2d 388 (Iowa 2001) (holding Iowa Code Ann. § 668A.1(a) sets the standard for awarding punitive damages).

- Are punitive damages insurable?

    - Punitive damages can be insurable. The Iowa Supreme Court has construed policy language providing coverage for "all sums" to include both compensatory and punitive damages and that such construction comports with the rule that "insurance contracts should be construed 'from the standpoint of what an ordinary man would believe the contract to mean.'" *Skyline Harvestore Systems, Inc. v. Centennial Ins. Co.*, 331 N.W.2d 106, 107 (Iowa 1983) (citations omitted) (finding further that insurance coverage of punitive damages does not violate public policy as the public policy purposes underlying punitive damages are punishment and deterrence); *see also City of Cedar Rapids v. Northwestern National Insurance Company of Milwaukee, Wisconsin*, 304 N.W.2d 228, 231 (Iowa 1981) (providing that coverage of "all sums" in a policy includes actual or compensatory damages as well as punitive damages).

    - However, the *Skyline* Court seemingly qualified this allowance by explaining "an insurer assumes a duty to define, in clear and explicit terms, any limitations or exclusions to coverage expressed

by broad promises." *Skyline*, 331 N.W.2d at 107 (citing *Zenti v. Home Insurance Co.*, 262 N.W.2d 588, 590 (Iowa 1978)).

- Can punitive damages assessed against the insured, after the insurer fails to settle, be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Currently, there is no caselaw in Iowa addressing this specific issue.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Currently, there is no caselaw in Iowa addressing this issue.

    - See *Petersen v. Farmers Cas. Co.* (Iowa 1975) 226 N.W.2d 226 (where an insurer informed its insured that it would appeal a judgment against the insured, the insurer was chargeable with the knowledge of the defense counsel it selected and liable for that counsel's failure to perfect an appeal).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practice Act, or some other consumer protection statute) and its main provisions.

    - Iowa Code Ann. § 516.1, "Inurement of policy":

        - This statute may be used by third parties to bring an excess judgment suit by direct action, but it only gives a third-party a right against an insurer that the insured would have if the insured had paid the judgment. *Long v. McAllister*, 319 N.W.2d 256, 262 (Iowa 1982).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- Third parties do not have a tort cause of action for bad faith. *Long v. McAllister*, 319 N.W.2d 256, 262 (Iowa 1982) ("We also decline to recognize a duty of the insurer to the victim under general tort concepts"); *Westview, Inc. v. Iowa Mut. Ins. Co.*, 728 N.W.2d 224 (Iowa Ct. App. 2006) ("…Iowa does not recognize a third-party bad faith tort action between a third-party claimant and the tortfeasor's insurer").

    - Iowa courts have been careful, however, to distinguish *Long* from "third-party excess judgment cases and first-party actions." *Bates v. Allied Mut. Ins. Co.*, 467 N.W.2d 255, 258 (Iowa 1991). "In each of those situations the duty of good faith arises out of the insurance contract and runs from the insurer to the insured. In an **excess judgment case**, the issue is whether the insurer is guilty of bad faith toward the insured in failing to settle an injured party's claim within policy limits. In a **first-party action**, the issue is whether the insurer is guilty of bad faith in failing to pay the insured's own claim. The reasoning behind these decisions is that while an insurer has a fiduciary relationship with its insured, it has an adversarial relationship with a third-party claimant. Therefore, a tort victim, as a third-party claimant, cannot compel a tortfeasor's insurer to negotiate and settle a claim in good faith anymore than he could compel the tortfeasor to do so himself." *Id.* (citations omitted) (emphasis added).

    - Additionally, there are situations where "the injured party, received from the tortfeasor, as part of a settlement, an **assignment** of the tortfeasor's claim for bad faith against its own insurance company." *Id.* (discussing *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790 (Iowa 1988) and *Kooyman v. Farm Bureau Ins. Co.*, 315 N.W.2d 30 (Iowa 1982)). Cases such as these are "based on a relationship between the insurer and the insured. It does not involve parties to an adversarial relationship as in *Long* . . ." *Id.*

- Therefore, in Iowa, the phrase "Third Party Bad Faith" is used to describe two different scenarios where there are causes of action,

separate and apart from the traditional definition of "Third Party Bad Faith":

- 1: A cause of action for third-party bad faith "arises when an insurer, in bad faith, breaches an agreement to indemnify [or defend] its insured against potential liability to third persons." *Kelly v. State Farm Mut. Auto. Ins. Co.*, 764 F. Supp. 1337, 1340 (S.D. Iowa 1991).
    - There is no distinction between failure to pay a claim and failure to represent an insured against a third-party.
- 2: When the injured party receives from the tortfeasor/insured an assignment of the tortfeasor's claim for bad faith against its insurance company. *See Bates*, 467 N.W.2d at 258.

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; wrong but reasonable")?
    - Because third parties do not have a tort cause of action for bad faith, it follows that in those situations, there are no defenses, as there is no cause of action.
    - Where the third party is assigned a claim by the insured, an insurer may reject a demand for settlement, only if it has a reasonable basis to believe that the demand is unreasonable. *Johnson v. American Family Mut. Ins. Co.*, 674 N.W.2d 88, 90 (Iowa 2004) (involving an automobile accident victim, as the tort-feasor's assignee, bringing suit against the insurer to recover for bad-faith refusal to settle for policy limits).
    - Iowa courts suggest a higher standard is required in third party disputes for the doctrine of "genuine dispute" due to the fiduciary obligations a liability insurer owes to a policyholder. *North Iowa State Bank v. Allied Mut. Ins. Co.*, 471 N.W.2d 824, 829 (Iowa 1991) ("The fiduciary duty required of an insurer in a third-party claim arises only when the insurer is required to represent the insured's position against a third party. In a first-party claim . . . the insurer

occupies the same arm's-length position in relation to an insured that it occupies when the insurer challenges an insured's coverage of casualty losses.").

- What are recoverable damages for the bad faith cause of action?

    - The Eighth Circuit has stated it believes the "Iowa Supreme Court characterizes bad faith failure to settle a third party's claim against an insured as a tort . . . we believe the Iowa Supreme Court would permit" a third party to recover emotional distress damages against the insurer for bad faith. *Berglund v. State Farm Mutual Auto. Ins. Co.*, 121 F.3d 1225, 1229 (8th Cir. 1997). To hold otherwise, the court stated, would prevent full recovery. *Id.*

KANSAS

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Insureds have remedies, but not strictly a "bad faith" claim.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - There are no statutory grounds for the bad faith cause of action.

    - Legislative provisions such as those regulating unfair claim settlement practices, K.S.A. § 40-2404, and unfair or deceptive consumer practices, K.S.A. § 50-623 (1983), are meant to provide remedies for insureds against their insurers.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Kansas courts have held that the legislature intended to provide a remedy for an insured's problems with its insurer. *Spencer v. Aetna Life & Cas. Ins. Co.*, 227 Kan. 914 (Kan. 1980); *see also Resolution Trust Corp. v. Fidelity & Deposit Co. of Maryland*, 885 F.Supp. 228 (D.Kan. 1995).

    - *Wade v. Emcasco Ins. Co.*, 483 F.3d 657, 666 (10th Cir. 2007)[applying Kansas law].

        - There is however an implied covenant of good faith and fair dealing in every contract under Kansas law.

    - There is no fiduciary relationship present in a first-party situation.

- Kansas law allows insureds to bring an action against an insurer for the tort of outrage. *Weathers v. American Family Mut. Ins. Co.*, 793 F. Supp. 1002, 1020–21 (D. Kan. 1992) (citing *State Farm Fire & Cas. Co. v. Liggett*, 689 P.2d 1187 (Kan. 1984)). The tort of outrage and the tort of bad faith are "mixed concepts used somewhat interchangeably." *Spencer*, 611 P.2d at 153.

- What are the applicable statutes of limitations?

  - 5 years for breach of written contract claims. Kan. Stat. Ann. § 60-511.

  - 2 years for when the insured brings a claim based on an independent tort. Kan. Stat. Ann. § 60-513.

- What are the recoverable damages for the bad faith cause of action?

  - Damages may include attorney's fees. *Evans v. Provident Life & Accident Ins. Co.*, 815 P.2d 550 (Kan. 1991).

  - Lost income and lost profits are recoverable as consequential damages arising from an insurer's failure to pay without just cause or excuse. *Mo. Med. Ins. Co. v. Wong*, 676 P.2d 113, 124 (Kan. 1984).

  - Generally, emotional distress damages are not available unless there is a showing that the insurer's actions were wanton or reckless and caused bodily harm. *Frickey v. Equity Mut. Ins. Co.*, 576 P.2d 702, 705–06 (Kan. Ct. App. 1978).

  - Kansas courts have held that other adequate remedies include:

    - K.S.A. § 40-219 (enjoining insurance company who fails to pay for loss within three months after final judgment and permitting an injunction against doing business until judgment is fully paid).

    - K.S.A. § 40-254 (fines of $500 or imprisonment for any person in violation of the act).

- K.S.A. §40-908 (insurance company must pay insured's attorneys fees if insured obtains judgment and insurer failed to pay full amount of loss without just cause or excuse).

- K.S.A. § 40-3111 (insurance company must pay attorneys fees if an insurer unreasonably refuse or delayed in making a proper payment).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - If the insured can prove that the insurer committed an independent tort with malice, fraud, or wanton disregard for the rights of others, punitive damages may be awarded. *Guarantee Abstract & Title Co., Inc. v. Interstate Fire & Cas. Co., Inc.*, 652 P.2d 665, 667–68 (Kan. 1982); *Weathers v. American Family Mut. Ins. Co.*, 793 F. Supp. 1002 (D. Kan. 1992); *Smith v. Hawkeye-Sec. Ins. Co.*, 842 F. Supp. 1373, 1375 (D. Kan. 1994).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - In a case where the insurance company recognized its conflict of interest with the insured because of allegations of intentional and negligent conduct, the Kansas Supreme Court held that the proper procedure was to hire independent counsel to defend the insured and notify the insured it was reserving all its rights. *Patrons Mutual Ins. Co. v. Harmon*, 732 P.2d 741, 745 (Kan. 1987).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- Under Kansas law, an insurer owes a duty in third-party claims to its insured to act in good faith and without negligence. A fiduciary relationship exists between insurer and insured. However, this does not rise to the level of a tort for third-parties or for first-parties.

KENTUCKY

Introductory Note: Those looking at bad-faith law in Kentucky for the first time should start with *Motorists Mutual v. Glass*, 996 S.W.2d 437 (Ky. 1999). *Glass* deals with first- and third-party claims, discusses the history of each, and places prior bad faith cases in the perspective of that history. It is a scholarly opinion and an excellent primer.

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)?
    - Yes.
        - *Motorists Mutual v. Glass*, 996 S.W.2d 437 (Ky. 1999).
        - Bad Faith Update Six Essential Cases, Mike Breen. 66 KY Bench & Bar 6 (March 2002); Duty of Liability Insurer to Compromise Litigation, 26 KY, L.J. 100, Jan. 1938.
- Can third parties sue for bad faith (i.e., third party bad faith)?
    - Yes.
        - *State Farm v. Reeder*, 763 S.W.3d 116 (Ky. 1988).
        - KRS 446.070 provides a claim to any person injured by the violation of another Kentucky statute. Through this statute, third parties can sue for violations of KRS 304.12-230, Kentucky's Unfair Claims Settlement Practices Act (UCSPA), which is nearly identical to the Model Act.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.
    - Yes, under KRS 304.12-230, the Kentucky Unfair Claims Settlement Practices Act ("UCSPA"), which lists 15 unfair acts.

- Claimants may also have a claim for violation of Kentucky's Consumer Protection Act, KRS 367.110 *et seq.* The purchase of a policy is a service intended to be covered by the Act—*Stevens v. Motorists Mut. Ins. Co.*, 759 S.W.2d 819 (Ky. 1988)—but the failure to settle a claim is not, in and of itself, an unfair act contemplated by the Act. *State Farm Fire & Casualty Ins. Co. v. Aulick*, 781 S.W.2d 531 (Ky. App. 1989).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Yes, the first-party duty-to-settle claim arises under the implied covenant of good faith inherent in every contract. *Grundy v. Manchester Ins. & Indem. Co.*, 425 S.W.2d 735, 737 (Ky. 1968).

  - Standards: *Wittmer v. Jones*, 864 S.W.2d 885, 890 (Ky. 1993):

    - Whether a bad-faith claim arises under common law or under the UCSPA, the claimant must prove three elements to prevail:

      > (1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed. *Id.*

    - Technical violations of the UCSPA are not actionable. There must also be "evidence sufficient to warrant punitive damages." *Id.* That means the claimant must show that the insurer acted with an "evil motive," or "reckless indifference to the rights of others." *Id.*

    - *See also*, *Motorists Mut. v. Glass, supra* 996 S.W.2d at 452: "[M]ere delay in payment does not amount to outrageous

conduct absent some affirmative act of harassment or deception."

- Duty to settle: Although the insurer has a duty to its insured to settle claims within its policy limits when it can reasonably do so, that duty does not arise until a claimant makes a demand within the policy limits. There is no affirmative duty on the carrier to "seek out the claimant and offer settlement in order to avoid a charge of bad faith." *Davis v. Home Indem. Co.*, 659 S.W.2d 185, 189 (Ky. 1983).

- Duty to defend: Under *Cincinnati Ins. v. Vance*, 730 S.W.2d 521 (Ky. 1987), an insurer may deny coverage and refuse to provide a defense. But if that denial is found to be wrongful in subsequent coverage litigation, the insurer becomes responsible for the amount of any verdict rendered against the insured without regard to policy limits.

- The insurer may also be bound by any settlement agreement reached between the claimant and the insured, although it is not necessarily bound by the agreed-upon damages.

- Under *Vance* most insurers defend under a reservation of rights unless their coverage position appears airtight. However, an insured is not required to accept a defense under reservation of rights. *Medical Protective Co. v. Davis*, 581 S.W.3d 25 (Ky. 1979).

- Parties

    - Both insurers and individual adjusters have been sued for violations of the UCSPA. But Kentucky has never ruled on whether individual adjusters may be sued for common-law bad faith. Because of Kentucky's stringent summary-judgment standard, many plaintiffs who sue out-of-state insurers will join adjusters who reside in Kentucky to destroy diversity.

    - In the absence of Kentucky law on point, a significant body of case law exists in the Eastern and Western federal districts regarding fraudulent joinder for defeating diversity

jurisdiction. Under Sixth Circuit law, a defendant is fraudulently joined if there is no reasonable basis to predict that the state law would impose liability under the facts pleaded in the complaint. *Alexander v. Elec. Data Sys. Corp.*, 13 F.3d 940, 949 (6th Cir. 1994). For representative cases see *Lisk v. Laroque*, 2008 U.S. Dist. LEXIS 4030 (W.D.Ky. 2008)(finding fraudulent joinder); *Malone v. Cook*, 2005 U.S. Dist LEXIS 24962 (W.D.Ky. 2005)(finding fraudulent joinder); *Gibson v. Am. Mining Ins. Co.*, 2008 U.S. Dist. LEXIS 82205 (E.D.Ky. 2008)(rejecting fraudulent joinder argument).

Update: In *Western Leasing, Inc. v. Acordia of Kentucky, Inc.*, 2010 Ky. App. LEXIS 81 (May 7, 2010), the court upheld the dismissal of an UCSPA claim against Acordia, who was the plaintiff's agent for procuring insurance the plaintiff. The UCSPA was intended to regulate the conduct of insurance companies. The statute regulates the conduct only of persons who enter into contracts of insurance. Brokers do not actually enter into such contracts; they procure such contracts of behalf of their principals.

On March 16, 2011, the Kentucky Supreme Court denied a motion for discretionary review, but ordered the Court of Appeals case not to be published. The unpublished opinion may be cited, not as precedent, but for a court's consideration "if there is no published opinion that would adequately address the issue before the court." See Kentucky Rule of Civil Procedure 76.28(4)(c).

- Self-insured entities are not subject to claims for bad faith. *Davidson v. American Freightways, Inc.*, 25 S.W.3d 94 (Ky. 2000).

- Workers' compensation carriers are not subject to statutory claims under the UCSPA or the Consumer Protection Act; workers are limited to the remedies available under the Workers' Compensation Act, KRS Chapter 342.

- Procedure

        - Bifurcation—Trial courts are required to bifurcate bad-faith claims, trying them after the underlying claim is resolved, and only if it is resolved in favor of the claimant. *Wittmer.* In practice, some courts schedule the bad-faith case to follow the underlying case immediately, if necessary. Most will set the bad-faith case much later.

        - Bifurcation of Discovery—*Wittmer* does not speak to whether trial courts should hold discovery in abeyance pending the resolution of the underlying claims. The practice varies from jurisdiction to jurisdiction—and in those jurisdictions having more than one trial judge, from judge to judge. Some judges are convinced that allowing discovery to proceed while the underlying case is unresolved prejudices the insured (in a first-party case) and the insurer (in first- and third-party cases.) Others are convinced that any issue that arises can be dealt with through motions for protective orders.

- What are the applicable statutes of limitation?

    - There has been no case in Kentucky yet that has determined the proper statute of limitations of a first-party bad-faith claim. There are three possibilities, none shorter than five years:

        - KRS 413.120(5) sets a five-year limit upon claims arising from the violation of another statute, if the other statute does not contain an internal limitation. To the extent a bad-faith claim is based on a violation of the UCSPA this statute could apply

        - KRS 413.120(12) sets a five-year limitation on actions for fraud. Because the UCSPA makes certain misrepresentations by insurers actionable, bad-faith cases in Kentucky are sometimes phrased in the language of fraud. Under KRS 413.130(3), actions for fraud do not accrue until they are discovered, but in no case may such actions be brought more than 10 years after the alleged fraud.

        - 413.090(2) sets a 15-year limitation on actions arising on a written contract.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - An insurer is always "entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts." *Wittmer*, 784 S.W.2d at 890. This is usually referred to as the "reasonable-basis" defense. Whether the insurer had a reasonable basis in law or in fact to deny a claim is generally a jury question. However, "where there is a legitimate first-impression coverage question for purposes of Kentucky law and recognized authorities support the insurer's position . . . the insured's claim is fairly debatable as a matter of law." *Empire Fire & Marine Insurance Company v. Simpsonville Wrecker Service, Inc.*, 880 S.W.2d 886 (Ky.App. 1994). This rule is tempered by *Farmland Mut. Ins. Co. v. Johnson*, 36 S.W.3d 368 (Ky. 2000), which held that the mere existence of a fairly debatable issue does not immunize an insurer from bad faith. "In other words, although elements of a claim may be 'fairly debatable,' an insurer must debate the matter fairly." *Id.*, 375. Debates over the amount of a claim generally present a jury issue. *Id.*, 376.

- What are the recoverable damages for the bad faith cause of action?

    - Consequential damages flowing from the breach of contact.
    - Damages for mental suffering and anguish.
    - Attorneys' fees (KRS 304.12-235).
    - Interest (KRS 304.12-235).
    - Punitive damages.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - The trial judge must determine that sufficient evidence exists to warrant a punitive damages instruction before allowing a bad-faith claim to go to the jury. Thus, the same evidence that permits a finding of bad faith also supports an award of punitive damages; that is, evidence that the insurer acted with "evil motive" or a

"reckless disregard to the rights of others." *Wittmer*, 784 S.W.2d at 890.

- However, *Wittmer* does not mandate that a punitive damages instruction be given in all bad faith cases. *Motorists Mut. Ins. v. Glass*, 996 S.W.3d 437, 463 (Ky. 1997).

- Are punitive damages insurable?

  - Yes, under limited circumstances. An insurer is not required to insure against an award of punitive damages.

    - *Continental Ins. Cos. v. Hancock*, 507 S.W.3d 146, 151 (Ky. 1973) (it does not violate public policy to insure against punitive damages where such damages are imposed for gross negligence, rather than intentional conduct.)

    - Uninsured Motorist carriers are not *required* to insure against punitive damages, and policy language which requires an insurer to pay only damages resulting from bodily injury does not obligate the insurer to pay punitive damages awarded against the uninsured motorist. *Kentucky Cent. Ins. Co. v. Schneider*, 15 S.W.3d 373 (Ky. 2000).

    - Specific exclusion for punitive damages in underinsured motorist coverage upheld. *Hodgin v. Allstate Ins. Co.*, 935 S.W.2d 614 (Ky. App. 1996).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - No.

- Can punitive damages, assessed against the insured after the insurer fails to settle, be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - Unknown. No Kentucky case specifically allows such a recovery. As noted above, *Cincinnati Ins. Co. v. Vance*, 730 S.W.2d 521 (Ky. 1987), held that if an insurer's decision not to defend was incorrect,

it becomes liable for the judgment against its insured, without regard to policy limits. This is in addition to other "damages naturally flowing from the breach" of the duty to defend. However, the underlying judgment in *Vance* did not contain an award of punitive damages.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Possibly. No Kentucky case would directly support a claim against an insurer based on the negligence of defense counsel. Older case law might indirectly support such a claim: "The insurer, as a professional defender of law suits, is held to a standard higher than that of an unskilled practitioner." *State Farm Mutual Automobile Ins. Co. v. Marcum*, 420 S.W.2d 113, 120 (Ky. 1967). However, more recent case law suggests that the insurer's role in defense must be a limited one. *See, American Insurance Association v. Kentucky Bar Association*, 917 S.W.2d 568 (Ky. 1996). Insurers are not permitted to practice law (*id.*at 571), and may not use in-house counsel to defend insureds under a liability policy. *Id.* at 570-71. Furthermore, attempts by insurers to interfere with appointed defense counsel's exercise of professional judgment are prohibited. *Id.* Under such circumstances, where the insurer's ability to direct counsel is so strictly limited, holding the insurer liable for defense counsel's acts or omissions does not seem logical. The potential for bad faith would seem more likely where there is evidence that an insurer may have exceeded those restrictions.

THIRD-PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Third parties have only a statutory claim for violation of the UCSPA. They may not bring claims for common-law bad faith, because they are not parties to the contract that contains the duty of good faith. *Grundy v. Manchester Ins. & Indem. Co.*, 425 S.W.2d 735, 737 (Ky. 1968).

- Nor may they bring claims for violation of the Consumer Protection Act, because as third parties they are not the consumer who purchased the policy, and so have no standing. *Anderson v. National Sec. Fire & Casualty Co.*, 870 S.W.3d 432 (Ky.App. 1993).

- Statutory bad-faith claims are subject to the same *Wittmer* elements set forth above. A claimant must show (1) that the insurer owed the claim; (2) that the insurer refused to pay the claim; and (3) that the refusal was without a reasonable basis, or with reckless disregard as to whether such a basis existed.

- Third parties may also bring bad-faith claims via assignment. *Grundy v. Manchester Ins. & Indem. Co.*, 425 S.W.2d 735, 737 (Ky. 1968).

- The insured may assign its claim after suffering an excess verdict, or before any verdict is rendered, if the insurer refuses to defend. *Id.*

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Third parties have only a statutory claim for violation of the UCSPA. They may not bring claims for common-law bad faith, because they are not parties to the contract that contains the duty of good faith. *Grundy v. Manchester Ins. & Indem. Co.*, 425 S.W.2d 735, 737 (Ky. 1968).

- What are the applicable statutes of limitations?

    - There is no definitive Kentucky case on this issue. The most likely answer is five years under KRS 413.120(5) (governing statutory claims where the statute has no internal statute of limitation); or KRS 413.120(12) (governing claims based on fraud), as discussed above.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

- The same defenses available in first-party claims, discussed above.

- What are the recoverable damages for the bad faith cause of action?
    - See discussion of first-party claims.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?
    - See discussion of first-party claims.

LOUISIANA

Introductory Note:

Unlike the rest of the United States, Louisiana is a civil law jurisdiction; it is not a common law state. As a result, the genesis of its bad faith laws lies in the Louisiana Civil Code and the Louisiana Revised Statutes rather than in the state's court decisions.

This is not meant to imply that civil law jurisdictions like Louisiana do not rely on judicial interpretation. They do. Civil law legal systems simply rely on judicial interpretation in different ways from their common law counterparts. In the context of case law, for example, common law jurisdictions use *stare decisis* to form binding precedent, whereas civil law jurisdictions use *jurisprudence constante*. Simply put, common law states tend to view a new, single decision as binding. This is *stare decisis*. Civil law states like Louisiana use *jurisprudence constante*, which requires a series of decisions, rather than one, to form binding precedent. When a new case is released in Louisiana, it does not automatically change the law. It is certainly relevant, important, and persuasive, but a single, lone case can be ignored by a judge in Louisiana much more easily than a judge in a common law jurisdiction because it is not seen as having the same kind of binding, precedential impact.

SUMMARY:

- Can insureds sue for bad faith (*i.e.*, first party bad faith)? Yes, but only in certain, limited circumstances.

- Can third parties sue for bad faith (*i.e.*, third party bad faith)? Yes, but only in certain, limited circumstances.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (*i.e.*, an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. Louisiana's two primary bad faith statutes are La. R.S. 22:1892 and 22:1973. It should be noted that Louisiana's bad faith statutes were renumbered several years ago, and many of the Louisiana

cases discussing bad faith refer to these statutes' previous designations, which were La. R.S. 22:658 and La. R.S. 22:1220, respectively. Pertinent portions of the statutory texts provided below have been set in bold-face font and underlined for emphasis.

- Louisiana Revised Statute 22:1892 provides, in pertinent part:

A. *(1) All insurers issuing any type of contract . . . shall pay the amount of any claim **due any insured** within thirty days after receipt of satisfactory proofs of loss from the insured or any party in interest. The insurer shall notify the insurance producer of record of all such payments for property damage claims made in accordance with this Paragraph.*

(2) All insurers issuing any type of contract . . . shall pay the amount of any third party property damage claim and of any reasonable medical expenses claim due any bona fide third party claimant within thirty days after written agreement of settlement of the claim from any third party claimant.

*(3) Except in the case of catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim and of a claim for reasonable medical expenses within fourteen days after notification of loss **by the claimant**. In the case of catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim within thirty days after notification of loss **by the claimant** except that the commissioner may promulgate a rule for extending the time period for initiating a loss adjustment for damages arising from a presidentially declared emergency or disaster or a gubernatorially declared emergency or disaster up to an additional thirty days. Thereafter, only one additional extension of the period of time for initiating a loss adjustment may be allowed and must be approved by the Senate Committee on Insurance and the House Committee on Insurance, voting separately. Failure to comply with the provisions of this Paragraph shall subject the insurer to the penalties provided in R.S. 22:1973.*

*(4) All insurers shall make a written offer to settle **any property damage claim**, including a third party claim,*

within thirty days after receipt of satisfactory proofs of loss of that claim.

B. (1) Failure to make such payment within thirty days after receipt of such satisfactory written proofs and demand therefore or failure to make a written offer to settle ***any property damage claim****, including a third party claim, within thirty days after receipt of satisfactory proofs of loss of that claim, as provided in Paragraphs (A)(1) and (4), respectively, or failure to make such payment within thirty days after written agreement or settlement as provided in Paragraph (A)(2), when such failure is found to be arbitrary, capricious, or without probable cause, shall subject the insurer to a penalty, in addition to the amount of the loss, of fifty percent damages on the amount found to be due from the insurer* ***to the insured****, or one thousand dollars, whichever is greater,* ***payable to the insured****, or to any of said employees, or in the event a partial payment or tender has been made, fifty percent of the difference between the amount paid or tendered and the amount found to be due as well as reasonable attorney fees and costs. Such penalties, if awarded, shall not be used by the insurer in computing either past or prospective loss exposure for the purpose of setting rates or making rate filings.*

* * * * *

- Louisiana Revised Statute 22:1973 states in relevant part:

(A) An insurer … owes ***to his insured*** *a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims* ***with the insured*** *or the claimant, or both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.*

(B) Any one of the following acts, if knowingly committed or performed by an insurer, constitutes a breach of the insurer's duties imposed in Subsection A:

(1) Misrepresenting pertinent facts of insurance policy provisions relating to any coverage at issue.

(2) Failing to pay a settlement within thirty days after an agreement is reduced to writing.

(3) Denying coverage or attempting to settle a claim on the basis of an application which the insurer knows was altered without notice to, or knowledge or consent of, the insured.

(4) Misleading a claimant as to the applicable prescriptive period.

*(5) Failing to pay the amount of any claim due **any person insured** by the contract within sixty days after receipt of satisfactory proof of loss from the claimant when such failure is arbitrary, capricious, or without probable cause.*

(6) Failing to pay claims pursuant to R.S. 22:1893 when such failure is arbitrary, capricious, or without probable cause.

*(C) In addition to any general or special damages to which **a claimant** is entitled for breach of the imposed duty, **the claimant** may be awarded penalties assessed against the insurer not to exceed two times the damages sustained or five thousand dollars, whichever is greater….*

- Is there a common law/judicially created bad faith cause of action (*i.e.*, the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. Louisiana is a civil law jurisdiction; it is not a common law state. As a result, the genesis of its bad faith laws lies in the Louisiana Civil Code and the Louisiana Revised Statutes rather than in the state's court decisions.

- What is the applicable statute of limitations?

    - Louisiana law is not settled on this issue, and a specific prescriptive period is not provided in the bad faith statutes.

    - "Prescription" and "Peremption" are Louisiana's versions of "Statutes of Limitation" and "Statutes of Repose", which are common law terms.

    - Most Louisiana claims are governed by either the prescriptive period for tort actions (*i.e.*, delictual actions), which is one year,[1] or the default prescriptive period for contract claims, which is ten years.[2]

    - Some courts have applied the ten year prescriptive period to bad faith claims[3] – even with respect to claims by third parties who had no direct contractual relationship with the insurer[4] – and other courts have ruled in favor of a one year prescriptive period.[5]

    - Because a plaintiff generally cannot assert a successful bad faith claim without first having a valid underlying claim upon which insurance coverage is based,[6] some Louisiana courts have analyzed whether a bad faith claim is prescribed by looking to whether the underlying claim has prescribed. In other words, these courts were receptive to the idea that bad faith penalties are subject to the same prescriptive period as the underlying claim against the policy up to a period of ten years, regardless of whether the claim is brought by

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1 La. C.C. art. 3492.

2 La. C.C. art. 3499.

3 *See, e.g.*, *We Sell Used Cars, Inc. v. United National Ins. Co.*, 30,671 (La.App. 2 Cir. 06/24/98), 715 So.2d 656, 660; and *Cantrelle Fence and Supply Co., Inc. v. Allstate Ins. Co.*, 550 So.2d 1306, 1308 (La.App. 1st Cir. 1989).

4 *See*, *Herbert v. Hill*, 37,208 (La.App. 2 Cir. 05/14/03), 855 So.2d 768, 770; *but see*, *Zidan v. USAA Property and Cas. Ins. Co.*, 622 So.2d 265 (La.App. 1st Cir. 1993) (Applying a one year prescriptive period to a third-party claim).

5 *See, e.g.*, *Harrell v. Fidelity Security Life Ins. Co.*, 2008 LEXIS 3440, *3 (E.D.La. 2008) (citing cases); *Brown v. Protective Life Ins. Co.*, 353 F.Supp.2d 739, 743 (E.D.La. 2004); *Yates v. Southwestern Life Ins. Co.*, 1998 LEXIS 2001, *14 (E.D.La. 1998) (citing cases); and *Marketfare Annunciation, LLC v. United Fire &Cas. Co.*, 2007 LEXIS 21476, *4-*5 (E.D.La. 2007).

6 *Clausen v. Fidelity & Deposit Co. of Maryland*, 95-0504 (La.App. 1 Cir. 08/04/95),660 So.2d 83, 86.

a first party or third party claimant.[7] Put another way, they felt that a ten year prescriptive period should apply to bad faith penalty claims unless the underlying claim for recovery under the policy had prescribed, such as by virtue of the one year tort limitation, a prescription provision in the policy, or specific statutory text limiting the timeframe for bringing the cause of action.[8] However, at least one Louisiana appellate court has disagreed with this approach because it results in the prescriptive period for bad faith penalties beginning to run before the prohibited actions by the insurer are actually committed.[9]

- Although there is no bright-line rule, our present review of the cases shows that Louisiana's federal courts seem more likely to apply a one year prescriptive period to a bad faith claim brought under La. R.S. 22:1973 (formerly La. R.S. 22:1220),[10] while Louisiana's state courts are more likely to use a ten year prescriptive period for claims brought under La. R.S. 22:1892 (formerly La. R.S. 22:658).[11]

- Insurers should consider each claim where prescription may be an issue on a case-by-case basis. Special consideration should be given to the nature of the claims as alleged in the pleadings and the character of the action (*i.e.*, Are the allegations more focused on tort-related actions or are they strictly contract-based?), as Louisiana courts will review the pleadings as part of a prescription determination.[12]

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7 *See, e.g.*, *Gordon v. State Farm &Cas.Co.*, 895 F.2d 1036, 1039-1040 (5th Cir. 1990); *Hampton v. Audubon Ins. Co.*, 41,833 (La.App. 2 Cir. 01/10/07), 948 So.2d 332, 334-335; *Harrell*, 2008 LEXIS 3440, *21 (citing cases).

8 *See, e.g.*, La. R.S. 9:5629 (Uninsured motorist claims); La. R.S. 22:868(B) (Group health and accident policies); La. R.S. 22:975(A)(11) (Health and accident policies); and La. R.S. 22:1311(F)(2)("Suit" provision of fire policy).

9 *See*, *Cantrelle*, 550 So.2d at 1308; and *Zidan*, 622 So.2d at 267 (Indicating a plaintiff's tort action may have prescribed and still have a bad faith penalty action).

10 *But see*, *Marketfare*, 2007 LEXIS 21476, *4-*5 (Stating that the one year prescriptive period applies to both penalty statutes.).

11 *But see*, *Zidan*, 622 So.2d 265 (Applying a one year prescriptive period to a third party claim under La. R.S. 22:1220 [Now La. R.S. 22:1973]).

12 *See*, *We Sell*, 715 So.2d at 658 (citing cases).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Any viable defenses to a bad faith claim will be based on the language of the bad faith statutes, so the defenses available will be fact-intensive and vary from case to case. In other words, because bad faith penalties are dependent upon a showing that an insurer has violated one of the prohibitions in the bad faith statutes, a defense strategy against such claims will always begin with the language of the statutes themselves.

    - Louisiana courts have interpreted La. R.S. 22:1892(A)(2) to require an actual written settlement agreement before a third party claimant can establish a bad faith claim.[13] However, the "writing" referenced by La. R.S. 22:1973(B)(2) is not the actual settlement agreement. The "writing" can be as informal as a letter from defense counsel accepting plaintiff's demand. Under this section, insurers cannot wait until the plaintiff has signed the final settlement agreement to fund the settlement.

    - Under La. R.S. 22:1892(A)(3), insurers must, "…*take some substantive and affirmative step to accumulate the facts that are necessary to evaluate the claim*"[14]; merely opening a file is not sufficient to meet this standard.[15]

    - The list of prohibited acts in La. R.S. 22:1973(B) is exclusive, not illustrative, so only the commission of one of these acts can support a bad faith claim under this statute.[16]

    - A plaintiff cannot assert a successful bad faith claim without first having a valid, substantive underlying claim upon which insurance coverage is based.[17]

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13 *Woodruff v. State Farm Ins. Co*., 99-2818 (La.App. 4 Cir. 6/14/00), 767 So.2d 785.

14 *Rogers v. Commercial Union Ins. Co*., 01-443 (La.App. 3 Cir. 10/3/01), 796 So.2d 862, 868 (citing cases).

15 *Id*.

16 T*heriot v. Midland Risk Ins. Co*., 95-2895(La. 05/20/97), 694 So.2d 184, 193.

17 *Clausen*, 660 So.2d at 86.

- An insurer takes the risk of misinterpreting its policy provisions, and if the insurer errs in interpreting its own policy provisions (even when the issues involved are unique), that error may still result in penalties and attorneys' fees for bad faith being assessed.[18] However, the mere fact that coverage is ultimately found to exist does not, in and of itself, warrant an assessment of penalties and attorneys' fees.[19] That is, where an insurer has legitimate doubts about coverage for a claim, the insurer has the right to litigate these questionable claims without being subjected to penalties and damages.[20]

- What are the recoverable damages for the bad faith cause of action?

  - The damages recoverable for bad faith claims are listed in the statutes themselves.

  - Under La. R.S. 22:1892, an insurer is liable for, *"…a penalty, in addition to the amount of the loss, of fifty percent damages on the amount found to be due from the insurer to the insured, or one thousand dollars, whichever is greater … or in the event a partial payment or tender has been made, fifty percent of the difference between the amount paid or tendered and the amount found to be due as well as reasonable attorney fees and costs.*"

  - Louisiana Revised Statute 22:1973(A) states that, "*Any insurer who breaches these duties [as described in the statute] shall be liable for any damages sustained as a result of the breach."* Subparagraph (C) adds that, *"In addition to any general or special damages to which a claimant is entitled for breach of the imposed duty [under the statute], the claimant may be awarded penalties assessed against the insurer not to exceed two times the damages sustained or five thousand dollars, whichever is greater…."*

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18 *See, e.g., Holland v. Golden Rule Ins. Co.*, 96-264 (La.App. 3 Cir. 10/09/96), 688 So.2d 1186; *Albert v. Cuna Mutual Ins. Society*, 255 So.2d 170 (La.App. 3d Cir. 1971); *Coltar v. Gulf Ins. Co.*, 318 So.2d 923 (La.App. 4th Cir. 1975); and *Smith v. Reserve Nat'l Ins. Co.*, 370 So.2d 186 (La.App. 3d Cir. 1976).

19 *See, e.g., Headrick v. Pennsylvania Millers Ins. Assoc.*, 245 So.2d 324 (La. 1971).

20 *Darby v. Safeco Ins. Co.*, 545 So.2d 1022, 1029 (La. 1989).

- In *Durio v. Horace Mann Ins. Co.*,[21] the Louisiana Supreme Court discussed how penalties under La. R.S. 22:1973 are to be calculated. Specifically, the Court stated that, "…penalties are calculated by doubling the amount of damages attributable to the insurer's breach of duties imposed under the statute."

- Are attorney fees recoverable?

  - Yes and No. Attorney fees are not awarded unless expressly provided for by statute or contract. Louisiana Revised Statute 22:1892(B)(1) specifically allows the recovery of "*reasonable attorney fees and costs*". Conversely, La. R.S. 22:1973 does not.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes, "Penalties" are recoverable subject to the limitations of the bad faith statutes.

  - Punitive damages may only be awarded in Louisiana if specifically provided by statute. For example, current Louisiana law expressly allows for punitive damages in cases involving drunk drivers[22] or sexual abuse of a minor.[23] The phrase "punitive damages" is not mentioned in either of the Louisiana bad faith statutes, but the statutes do provide for a "penalty" that can be assessed against an offending insurer.

- Are punitive damages insurable?

  - Yes,[24] <u>unless</u> they are assessed for voluntary or intentional acts of the insured.[25] In other words, no person in Louisiana can insure against his own intentional acts, but public policy does not forbid

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21 2011-0084 (La. 10/25/11), 74 So.3d 1159.

22 La. C.C. art. 2315.4.

23 La. C.C. art. 2315.7.

24 *See*, *Louviere v. Byers*, 526 So. 2d 1253 (La.App. 3d Cir. 1988).

25 *See*, *Baltzar v. Williams*, 254 So.2d 470 (La.App. 3d Cir. 1971); *Swindle v. Haughton Wood Co.*, 458 So.2d 992 (La.App. 2d Cir. 1984); *Vallier v. Oilfield Constr. Co.*, 483 So.2d 212 (La.App. 3d Cir. 1986); and *Creech v. Aetna Cas.& Surety Co.*, 516 So.2d 1168 (La.App. 2d Cir. 1987).

one from insuring against the intentional acts of another for whose acts the insured may be vicariously liable.[26]

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Potentially, yes, if the recovery by the insured is part of an excess judgment following an insurer's bad faith failure to settle. Again, there are only a limited number of situations in which Louisiana allows the recovery of punitive damages, so this situation does not occur frequently.

    - This is a *res nova* issue in Louisiana. For this to occur, a third party must have asserted a claim against an insured for which punitive damages are recoverable. If the third party made an offer to settle the claim within policy limits, and at that time had asserted a punitive damage claim, and the insurer failed to settle the claim within policy limits, and if a judgment was then rendered against the insured in excess of the policy's limits which included punitive damages, the insurer likely would have to pay the punitive damage portion of the claim, assuming again that the insurer was liable for bad faith failure to settle.

    - In *Maryland Cas. Co. v. Dixie Ins. Co.*,[27] the Louisiana First Circuit Court of Appeal addressed a bad faith failure to settle claim where the underlying judgment included punitive damages against an insured drunk driver. Although the recoverability of punitive damages as part of the excess judgment action was not directly argued, no indication was made by the appellate court that this was a concern even though the insurer had a punitive damages exclusion in its policy.

- Does the state follow the *Cumis* case (*i.e.*, require independent counsel when there is an insurer-insured conflict)?

    - This issue is not settled under Louisiana law.

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26 *McBride v. Lyles*, 303 So.2d 795, 799 (La.App. 3d Cir. 1974).

27 622 So.2d 698 (La.App. 1st Cir. 1993).

- The Louisiana Supreme Court has not addressed this issue, and the Louisiana Legislature has not passed any *Cumis*-style laws. With respect to a first party claim where the insured is disputing coverage and hires its own counsel to pursue coverage against its insurer, the insured still bears the cost of such representation.[28] However, in the context of a third party claim having been brought against an insured, a trend in favor of an insured's right to select its own defense counsel when a reservation of rights has been issued may be developing.

- In *Belanger v. Gabriel Chemicals, Inc*.,[29] a toxic exposure case, the policy contained a *Cumis*-style endorsement, and the Louisiana First Circuit Court of Appeal affirmed the insured's right to select its counsel and control the defense. However, the court also stated the insurer had the right to limit payment of attorney's fees as set forth in the endorsement as well as the right to insist that the attorney selected have certain minimum qualifications, including competency and insurance.

- A year after *Belanger*, the Louisiana Fifth Circuit Court of Appeal issued a similar ruling in *Smith v. Reliance Insurance Co. of Illinois*.[30] However, the policy in that case did not appear to contain a *Cumis*-type endorsement. Despite the lack of an endorsement, the appellate court still held that an insured had the right to choose its own counsel and that the insurer was obligated to pay "reasonable" defense costs.

- We believe that when the Louisiana Supreme Court eventually confronts the issue, and assuming the state of the caselaw remains as it is now, the Court will likely adopt the reasoning of *Belanger* and *Smith* and find that an insured has the right to independent counsel if the insurer has asserted a coverage defense which potentially puts the interests of the insurer and the insured in conflict.

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[28] *Dugas Pest Control of Baton Rouge, Inc. v. Mutual Fire, Marine and Inland Ins. Co.,* 504 So.2d 1051 (La.App. 1st Cir. 1987).

[29] 2000-0747 (La.App. 1 Cir. 05/23/01), 787 So.2d 559.

[30] 01-387 (La.App. 5 Cir. 01/15/02), 807 So.2d 1010.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Not likely, but this issue is not settled under Louisiana law.

    - This is a *res nova* issue in Louisiana which is best answered by determining whether an attorney is considered under Louisiana law to be the insurer's "employee" or an "independent contractor". This distinction is important because although an employer is generally liable for injuries caused by its employees,[31] a principal is typically not liable for offenses committed by an independent contractor while performing his or her contractual duties.[32]

    - The "employee" versus "independent contractor" distinction is fact-intensive and determined on a case-by-case basis.[33] Labeling someone as an "independent contractor" in a contract is not dispositive of the issue and has no impact on the rights of injured third parties.[34] While the existence of a contract may be a relevant factor, there is no requirement the contract even be in writing or witnessed,[35] and under some factual circumstances the presence of a contract may be "of no significance" at all.[36]

    - In determining whether an "independent contractor" or "employer/employee" relationship exists, Louisiana courts typically consider whether: 1) a valid contract exists between the two parties at issue, 2) the work being done is of an independent nature such that the contractor may employ nonexclusive means of accomplishing it, 3) the contract calls for specific piecework as a

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31 La. C.C. art. 2320.

32 *Ellerbe v. Albertsons, Inc.*, 43,452 (La.App. 2 Cir. 08/13/08), 989 So.2d 303, 305 (citing *Ledent v. Guar. Nat. Ins. Co.*, 31,346 (La.App. 2 Cir. 12/28/98), 723 So. 2d 531).

33 *Ellerbe*, 989 So.2d at 305 (citing *Tower Credit, Inc. v. Carpenter*, 2001-2875 (La. 9/4/02), 825 So.2d 1125); and *White v. Frederick*, 44,563 (La.App. 2 Cir. 08/19/09), 17 So.3d 1016, 1018.

34 *Ellerbe*, 989 So. 2d at 306 (citing *Hughes v. Goodreau*, 2001-2107 (La.App. 1 Cir. 12/31/02), 836 So.2d 649); and *White*, 17 So.3d at 1018.

35 *White*, 17 So.3d at 1021, n. 3 (citing *Tate v. Progressive Security Ins. Co.*, 2008-0950 (La.App. 4 Cir. 1/28/09), 4 So.3d 915).

36 *McLeod v. Moore*, 44,022 (La.App. 2 Cir. 04/08/09), 7 So.3d 190, 194 (citing *Tate*, 4 So.3d 915).

unit to be done according to the independent contractor's own methods without being subject to the control and direction of the principal, except as to the result of the services to be rendered, 4) there is a specific price for the overall undertaking, and 5) a specific time or duration is agreed upon and not subject to termination at the will of either side without liability for breach.[37] Of these factors, the primary inquiry is whether the principal retained the right to control the independent contractor's work, with the focus being on whether that right was retained by the principal, not whether the right was actually exercised.[38] For example, where a principal exercises no control over an alleged tortfeasor's day-to-day operations and where the tortfeasor autonomously decides when and where to work and who to hire to perform the work without input or control from the principal, the relationship is that of a principal and independent contractor.[39]

- The Louisiana Supreme Court, in *Hickman v. So. Pac. Trans. Co.*,[40] stated that, "The term independent contractor connotes a freedom of action and choice with respect to the undertaking in question and a legal responsibility on the part of the contractor in case the agreement is not fulfilled…."[41] The Court then further elaborated that a contract with an independent contractor should include, "…specific piecework as a unit to be done according to the independent contractor's own methods, without being subject to the control and direction, in the performance of the service, of his employer, except as to the result of the services to be rendered. It must also appear that a specific price for the overall undertaking is agreed upon; that its duration is for a specific time and not subject to termination or discontinuance at the will of either side without a corresponding liability for its breach."[42]

THIRD PARTY BAD FAITH:

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37 *Ledent*, 723 So.2d at 537-538 (citing cases); and *White*, 17 So.3d at 1018 (citing *Hickman v. So. Pac. Transport Co.*, 262 So.2d 385 (La. 1972)).

38 *Ledent*, 723 So.2d at 538 (citing cases); and *White*, 17 So.3d at 1018 (citing cases).

39 *See*, *Ledent*, 723 So.2d at 537 (citing cases).

40 262 So.2d 385 (La. 1972).

41 *Id* at 390 (citing *Amyx v. Henry & Hall*, 79 So.2d 483 (La. 1955)).

42 *Hickman*, 262 So.2d at 390-391 (citing *Amyx*, 79 So.2d 483).

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (*i.e.*, an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - See section above.

    - Louisiana Revised Statute 22:1892 provides, in pertinent part:

        A. (1) All insurers issuing any type of contract . . . shall pay the amount of any claim due any insured within thirty days after receipt of satisfactory proofs of loss from the insured or any party in interest. The insurer shall notify the insurance producer of record of all such payments for property damage claims made in accordance with this Paragraph.

        (2) All insurers issuing any type of contract . . . shall pay the amount of ***any third party*** *property damage claim and of any reasonable medical expenses claim due any bona fide* ***third party claimant*** *within thirty days after written agreement of settlement of the claim from* ***any third party claimant****.*

        (3) Except in the case of catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim and of a claim for reasonable medical expenses within fourteen days after notification of loss ***by the claimant****. In the case of catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim within thirty days after notification of loss* ***by the claimant*** *except that the commissioner may promulgate a rule for extending the time period for initiating a loss adjustment for damages arising from a presidentially declared emergency or disaster or a gubernatorially declared emergency or disaster up to an additional thirty days. Thereafter, only one additional extension of the period of time for initiating a loss adjustment may be allowed and must be approved by the Senate Committee on Insurance and the House Committee on Insurance, voting separately. Failure to comply with the provisions of this Paragraph shall subject the insurer to the penalties provided in R.S. 22:1973.*

*(4) All insurers shall make a written offer to settle **any property damage claim, including a third party claim**, within thirty days after receipt of satisfactory proofs of loss of that claim.*

*B. (1) Failure to make such payment within thirty days after receipt of such satisfactory written proofs and demand therefore or failure to make a written offer to settle **any property damage claim**, **including a third party claim**, within thirty days after receipt of satisfactory proofs of loss of that claim, as provided in Paragraphs (A)(1) and (4), respectively, or failure to make such payment within thirty days after written agreement or settlement as provided in Paragraph (A)(2), when such failure is found to be arbitrary, capricious, or without probable cause, shall subject the insurer to a penalty, in addition to the amount of the loss, of fifty percent damages on the amount found to be due from the insurer to the insured, or one thousand dollars, whichever is greater, payable to the insured, or to any of said employees, or in the event a partial payment or tender has been made, fifty percent of the difference between the amount paid or tendered and the amount found to be due as well as reasonable attorney fees and costs. Such penalties, if awarded, shall not be used by the insurer in computing either past or prospective loss exposure for the purpose of setting rates or making rate filings.*

* * * * *

- Louisiana Revised Statute 22:1973 states in relevant part:

*(A) An insurer … owes to his insured a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured **or the claimant**, or both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.*

(B) Any one of the following acts, if knowingly committed or performed by an insurer, constitutes a breach of the insurer's duties imposed in Subsection A:

(1) Misrepresenting pertinent facts of insurance policy provisions relating to any coverage at issue.

(2) Failing to pay a settlement within thirty days after an agreement is reduced to writing.

(3) Denying coverage or attempting to settle a claim on the basis of an application which the insurer knows was altered without notice to, or knowledge or consent of, the insured.

*(4) Misleading **a claimant** as to the applicable prescriptive period.*

(5) Failing to pay the amount of any claim due any person insured by the contract within sixty days after receipt of satisfactory proof of loss from the claimant when such failure is arbitrary, capricious, or without probable cause.

(6) Failing to pay claims pursuant to R.S. 22:1893 when such failure is arbitrary, capricious, or without probable cause.

*(C) In addition to any general or special damages to which **a claimant** is entitled for breach of the imposed duty, **the claimant** may be awarded penalties assessed against the insurer not to exceed two times the damages sustained or five thousand dollars, whichever is greater….*

- Is there a common law/judicially created bad faith cause of action (*i.e.*, the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.
    - See section above.

- What is the applicable statute of limitations?
    - See section above.
- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?
    - See section above.
- What are the recoverable damages for the bad faith cause of action?
    - See section above.
- Are attorney fees recoverable?
    - See section above.
- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?
    - See section above.
- Are punitive damages insurable?
    - See section above.

MAINE

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? Generally, no.

FIRST PARTY BAD FAITH

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - The Unfair Claims Settlement Practices statute, 24-A M.R.S.A. § 2436-A. and the late payment of claims statute, § 2436, provide for statutory interest and attorneys' fees in instances of improper actions by an insurer.

    - To establish a knowing misrepresentation of the Unfair Claims Settlement Practices statute, an insured must present evidence showing more than a mere dispute as to policy language, and must show that while the insurer meant one thing, it told the insured something else. An insurer is not liable if it acted within a reasonable basis. *Curtis v. Allstate Ins. Co.*, 787 A.2d 760, 768–69 (Me. 2002).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Maine courts have refused to recognize a first party cause of action in tort for bad faith. *Marquis v. Farm Family Mut. Ins. Co.*, 628 A.2d 644, 652 (Me. 1993).

    - However, a cause of action for bad faith arises out of contract. An insurer has an implied duty to act fairly and in good faith. *Linscott v. State Farm Mut. Auto Ins. Co.*, 368 A.2d 1161, 1163 (Me.1977).

- What are the applicable statutes of limitations?

    - 6 years for breach of contract claims. 14 M.R.S.A. § 752.

        - Cause of action for breach of contract accrues at time of the breach. Breach does not occur until the insurer refuses payment and notifies insured of rejection. *Palmero v. Aetna Cas. & Sur. Co.*, 606 A.2d 797, 798-99 (Me. 1992).

- What are the recoverable damages for the bad faith cause of action?

    - Traditional remedies for beach of contract are available to an insured if an insurer breaches its contractual duty to act in good faith. This includes consequential damages. *Marquis v. Farm Family Mut. Ins. Co.*, 628 A.2d 644 (Me. 1993).

    - Emotional distress damages are recoverable. *See Gibson v. Nat'l Ben Franklin Ins. Co.*, 387 A.2d 220 (Me. 1978).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Punitive damages are not available for breach of contract "no matter how egregious the breach." *Drinkwater v. Pattern Realty Corp.*, 563 A.2d 772, 776 (Me. 1989).

    - If an insured can prove that its insurer's conduct rose to a level of extreme and outrageous conduct, it may sue its insurer for the tort of intentional infliction of emotional distress, and recover punitive damages. This tort recovery must be based on actions separable from the actual breach of contract and independent from the insurer's denial. *Colford v. Chubb Life Ins. Co. of America*, 687 A.2d 609, 616 (Me. 1996).

THIRD PARTY BAD FAITH

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

- The Maine Unfair Claims Practices Act provides that §2164-D "may not be construed to create or imply a private cause of action for violation of this section." Section 8 of 24-A.M.R.S.A. §2164-D.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Third-party claimants have no right to assert bad faith. *Linscott v. State Farm Mut. Auto Ins. Co.*, 368 A.2d 1161, 1163-64 (Me.1977).

  - Third parties are limited to breach of contract actions, and may only sue for breach of contract if the contracting parties intended that the third-party have an enforceable right. *Fleet Bank of Maine v. Harriman*, 721 A.2d 658, 660–61 (Me.1998).

MARYLAND

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? With first party policy claims suit may only be based on a theory of breach of contract. However, with third party policy claims, Maryland permits a bad faith claim for failure to settle.

- Can third parties sue for bad faith (i.e., third party bad faith)? No. However, claims for bad faith failure to settle can be assigned.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - There are no statutory grounds for a bad faith cause of action.

    - Md. Com. Law. Code Ann. § 13-101 regulates unfair and deceptive trade practices.

    - Md. Insurance § 27-301, et seq., regulates Unfair Claims Settlement Practices.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Maryland courts have refused to recognize a first-party tort of bad faith. *Johnson v. Federal Kemper Ins. Co.*, 536 A.2d 1211 (Md. Ct. Spec. App. 1988).

    - An insured's cause of action is limited to breach of contract, as Maryland views disputes between an insurer and insured as a "traditional dispute between the parties to a contract." *Johnson v. Federal Kemper Ins. Co.*, 536 A.2d 1211, 1213 (Md. Ct. Spec. App. 1988).

- A bad faith cause of action may be available for claims by the insured against its insurer for failure to settle third-party liability claims. *Caruso v. Republic Ins. Co.*, 558 F.Supp. 430, 432 (D.Md. 1983).

- A tort duty may arise, but it must be separate from the insurer's contractual duty. Mere failure to perform a contractual obligation does not give rise to an actionable tort. *Mesmer v. Maryland Auto. Ins. Fund.*, 725 A.2d 1053, 1058 (Md. 1999).

- The insurer is only potentially liable for a tort if it actually defends the suit. If an insurer undertakes to defend the insured, and fails to use the appropriate standard of care, this may give rise to a tort action. Erroneously disclaiming coverage gives rise only to a contract action. *Mesmer*, 725 A.2d at 1061.

- What are the applicable statutes of limitations?

  - 3 years. Md. Code Ann., Cts. & Jud. Proc. § 5-101, et. seq.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Regarding bad faith failure to settle "the presence of one or more of the following acts or circumstances may affect the 'good faith' posture of the insurer: the severity of the plaintiff's injuries giving rise to the likelihood of a verdict greatly in excess of the policy limits; lack of proper and adequate investigation of the circumstances surrounding the accident; lack of skillful evaluation of plaintiff's disability; failure of the insurer to inform the insured of a compromise offer within or near the policy limits; pressure by the insurer on the insured to make a contribution towards a compromise settlement within the policy limits, as an inducement to settlement by the insurer; and actions which demonstrate a greater concern for the insurer's monetary interests than the financial risk attendant to the insured's predicament." *State Farm Auto Ins. Co. v. White,* 248 Md. 324, 332, 236 A.2d 269, 273 (1967).

- What are the recoverable damages for the bad faith cause of action?

- "Ordinarily the measure of damages in a bad faith failure to settle case is the amount by which the bonafide judgment rendered in the underlying action exceeds the amount of insurance coverage." *Kremen v. Md. Auto Ins. Fund*, 363 Md. 663, 675, 770 A.2d 170, 177 (2001).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - In an action for breach of insurance contract, punitive damages will not be allowed even where the insured can show actual malice. Damages are limited to those which naturally arise from the breach of contract and which can be shown to have been contemplated by the parties when they entered the contract. *Johnson v. Federal Kemper Ins. Co.*, 536 A.2d 1211, 1213 (Md. Ct. Spec. App. 1988).

- Are punitive damages insurable?

    - Maryland courts have held that public policy did not preclude coverage under liability insurance policy for exemplary damages assessed against insured. *First Nat. Bank of St. Mary's v. Fidelity & Deposit Co.*, 283 Md. 228, 389 A.2d 359, 362 (Md.1978).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Maryland law holds that punitive damages can be insurable, and it may follow that an excess judgment can include them.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - Under Maryland law, if there is an *actual* conflict of interest, independent counsel paid for by the insurer may be required. *Brohawn v. Transamerica Ins. Co.*, 276 Md. 396, 347 A.2d 842 (1975). However, the mere presence of a bad faith failure to settle does not create an actual conflict so as to entitle the insured to reimbursement for its own independent counsel fees incurred in

the defense of the case. *Allstate Ins. Co. v. Campbell*, 639 A.2d 652, 334 Md. 381 (1994).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Maryland has not issued a controlling ruling on this issue.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - A third-party does not have a tort cause of action against an insurer for bad faith. *Bean v. Allstate Ins. Co.*, 403 A.2d 793 (Md. 1979).

    - However, a tort cause of action may arise for an insured for a bad faith failure to settle with a third party. *State Farm Mut. Auto. Ins. Co. v. White*, 236 A.2d 269 (Md. 1967). The insured, who has a claim for bad faith failure to settle, may assign this right to a third party. *Allstate Ins. Co. v. Campbell*, 639 A.2d 652 (Md.1994). In order to have a valid claim for bad faith failure to settle, the insurer must have defended the action. *Mesmer v. Maryland Auto. Ins. Fund.*, 725 A.2d 1053, 1064 (Md. 1999).

MASSACHUSETTS

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes

- Can third parties sue for bad faith (i.e., third party bad faith)? Yes

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions

    - MASS. GEN. LAWS ch. 176D § 3(9) (Claims for Unfair Claims Settlement Practices)

    - MASS. GEN. LAWS ch. 93A § 9 (Remedy for deceptive practices.)

    - Duty of good faith: An insurer "has an obligation to act in good faith, to 'exercise common prudence to discover the facts as to liability and damages upon which an intelligent decision may be based.'" *Green v. Blue Cross and Blue Shield of Mass., Inc.*, 47 Mass. App. Ct. 443, 447 (Mass. App. Ct. 1999) (quoting *Murach v. Mass. Bonding and Ins. Co.*, 339 Mass. 184, 187 (1959)). The courts have further expanded on the concept of "good faith" by requiring that the insurer making settlement decisions without regard to the policy limits and the insurer's exercise of common prudence to discovery the facts as to liability and damages upon which an intelligent decision may be based. *Hartford Casualty Insurance Company v. New Hampshire Insurance Company*, 417 Mass. 115, 119 (1994) (third party claim quoting a first party claim) (*quoting Murach*, 339 Mass. at 187 (1959)). "So long as the insurer acts in good faith, the insurer is not held to standards of omniscience or perfection; it has leeway to use, and should consistently employ, its honest business judgment. *Peckham v. Continental Casualty Company*, 895 F.2d 830, 835 (1st Cir. 1990) (third party claim quotes first party claim) (*quoting Murach*, 339 Mass. at 187 (1959).

- Major provisions: Section 9(i) of Ch. 93A provides that "any person whose rights are affected by another person violating the provisions of M.G.L. c. 176D may bring an action." Whereas a private individual may seek under Section 9, businesses may only recover under Section 11 of Chapter 93A. The Supreme Judicial Court has ruled that a claim under 176D may not be brought under §11. *Jet Line Servs., Inc. v. American Employers Ins. Co.*, 404 Mass. 706, 717 n. 11 (1989); *Spencer Press, Inc. v. Utica Mutual Ins. Co.*, 42 Mass. App. Ct. 631, 636 (Mass. App. Ct. 1997).

- Insurer may sue Insured: Though a claim of violating M.G.L.c.176D may not be brought under Section 11 of Chapter 93A, an insurer may bring a claim against the insured for violation of Chapter 93A. *Sidney Binder, Inc. v. Jewelers Mut. Ins. Co,.* 28 Mass. App. Ct 459, 465 (Mass. App. Ct. 1990) ("[w]e think that the *International Fidelity* case stands for the proposition that insurance companies may pursue remedies under c. 93, as well as be pursued").

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No: See statutes; *Commonwealth v. De Cotis*, 366 Mass. 234, 244 (1974) ("Although Mass. Gen. Laws ch. 93A established new procedural devices to aid consumers and others (which in this respect could constitutionally be applied retroactively), Ch. 93A also created new substantive rights by making conduct unlawful which was not unlawful under the common law or any prior statute.").

- What are the applicable statutes of limitations?

    - 4 years after the case accrues. Mass. Gen. Law Ch. 260 §5A (2009).

        - Explanation: The language of Mass. Gen. Law ch. 260 §5A states that "*Actions arising on account of violations of*

any law intended for the protection of consumers … whether for damages, penalties or other relief and brought by any person, including the attorney general shall be commenced only within four years next after the cause of action accrues." Massachusetts courts expanded this language by holding that a claim did not accrue until the insured suffered an unprotected loss. *Int'l Mobiles Corp. v. Corroon & Black/Fairfield & Ellis, Inc.*, 29 Mass. App. Ct. 215, 220-21 (Mass. App. Ct 1990).

- Claims under Mass. Gen. Laws ch. 93A are governed by a four-year statute of limitations. Mass. Gen. Laws. ch. 260, § 5A. A cause of action under 93A typically accrues at the time injury results from the assertedly unfair or deceptive acts subject to the caveat that a cause of action does not accrue until the plaintiff discovers, or reasonably should have discovered, that she may have been injured as a result of the defendant's conduct. *Vaughnv. AAA*, 326 F.Supp. 2d 195 (D. Mass. 2004).

    - Massachusetts further refined this analysis by holding that an action regarding the allocation of losses did not accrue until a final rejection of plaintiff's position. *Nortek, Inc. v. Liberty Mut. Ins. Co.*, 65 Mass. App. Ct. 764, 769-770 (Mass. App. Ct. 2006) *rev. denied* 447 Mass. 1103 (2006).

    - However, this statute of limitation may be shortened based on the type of policy it is based on. For example, a federal district court has ruled that the two-year statute of limitations in a first-party fire insurance policy precluded coverage for contractual and extra-contractual claims arising out of the insurer's failure to accept coverage because this would allow the insured to circumvent Mass. Gen. Law ch. 175 §99. *Nunheimer v. Continental Insurance Company*, 68 F.Supp. 2d 75, 79-80 (D. Mass. 1999) ("Thus, allowing Nunheimer to bring claims under Chapters 93A and 176D based solely on a denial of benefits under a fire insurance policy would enable him to circumvent section 99, the law specifically establishing the two year statute of limitations for suits based on fire insurance policies.").

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Wrong but reasonable: Defenses pursuant to the statutory terms. "A plausibly reasoned legal position that may ultimately turn out to be mistaken--or simply . . . unsuccessful--is outside the scope of the punitive aspects of the combined application of 93A and 176D." *Guity v. Commerce Ins. Co.*, 36 Mass. App. Ct. 339, 342 - 44 (Mass. App. Ct. 1994), *rev. denied* 418 Mass. 1102 (Mass. 1994).

    - Undeveloped caselaw: An insurer is not liable for a coverage position where little or no legal precedent exists or which is otherwise reasonable even if the court ultimately rules that coverage, in fact, exists. *See City Fuel Corp. v. Nat'l Fire Ins. Co.*, 446 Mass. 638, 644 (2006)(*citing Polaroid Corp. v. The Travelers Indemnity Co.*, 414 Mass. 747, 763 (1993)).

    - Flawed but conscientious: An insurer may not be liable to a claims investigation that, while flawed in certain respects, was on the whole "conscientious." *Spencer Press, Inc. v. Utica Mutual Ins. Co.*, 42 Mass. App. Ct. 631 (Mass. App. Ct. 1997).

    - Advice of Counsel: Reliance on the advice of counsel may constitute "some evidence" of good faith. *See Tallent v. Liberty Mutual Ins. Co.*, 19 Mass. L. Rep. 460, but the cases in which insurers have successfully used the reliance on counsel as a defense are cases in which the insurer based a decision on independent legal advice or legal advice of its own counsel that was supported by an independent expert opinion. . *See Van Dyke v. St. Paul Fire & Marine Ins. Co.*, 388 Mass. 671, 673-674 (1983).

- What are the recoverable damages for the bad faith cause of action?

    - Per statute. The Massachusetts Courts have determined that single recovery shall be the amount of actual damages, meaning the foreseeable loss to a claimant caused by a violation of 176D. *Yeagle v. Aetna Casualty & Surety Co.*, 42 Mass. App. Ct. 650, 653 (1997). Chapter 93A goes on to say that in the particular

situation where the claimant has recovered a judgment on the underlying claim, "actual damages" shall be taken to be the amount of the judgment for purposes of bad faith calculations. *Id.* at 653, 654. These damages may also include attorney's fees as a measure of actual damages. *Columbia Chiropractic Group, Inc. v. Trust Ins. Co.*, 430 Mass. 60, 63 (1999).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes, Section 9 damages may be doubled or tripled where the violation was in bad faith. *See Yeagle v. Aetna Casualty & Surety Co.*, 42 Mass. App. Ct. 650, 653 (1997). Chapter 93A goes on to say that in the particular situation where the claimant has recovered a judgment on the underlying claim, "actual damages" shall be taken to be the amount of the judgment for purposes of bad faith calculations, but for that purpose only. *Id.* at 653, 654. Under 93A, § 9, punitive damages may only be awarded if the defendant acted willfully or knowingly, and the award must be between two and three times compensatory damages included in a judgment on any claim arising from the same and underlying transaction or occurrence. *See Rhodes v. AIG*, 461 Mass. 486, 503 (2012).

        - In 1989, the legislature amended Section 9 to specify that the amount trebled would encompass the entire underlying judgment, not just the damages directly attributable to the insured's conduct. When a case has been settled, according to Massachusetts courts, there is no "judgment" on which to base the multiple damage calculus. *See Clegg v. Butler*, 424 Mass. 413, 424 (1997).

        - Further, the term "judgment" has not encompassed an arbitrator's award for the purposes of calculation of multiple damages, but this position has been clarified. *See Rhodes v. AIG*, 461 Mass. 486, 503 (2012). In the *Rhodes* decision, the SJC stated that an arbitrator's award, for the purpose of an arbitrator's calculation of multiple damages under 93A, § 9, in an arbitral proceeding, is the equivalent of a judgment, and therefore an arbitrator is

not prohibited from awarding multiple damages on the full amount of the arbitration award, although a court would not be entitled to do so. *See Rhodes v. AIG*, 461 Mass. 486, 502 (2012).

- Are punitive damages insurable?

    - Directly assessed punitive damages are not insurable in Massachusetts. *See Santos v. Lumbermens Mutual Casualty Co.*, 408 Mass. 70 (1990). In *Santos*, the Court found no coverage for punitive damages under an uninsured motor policy or the state's underinsurance statute.

    - Whether vicariously assessed punitive damages are insurable has not been decided in Massachusetts.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Under Chapter 93A, a plaintiff is entitled to recover for all losses which were the foreseeable consequences of the insurer's unfair or deceptive practice. *See DiMarzo v. American Mut. Ins. Co.*, 389 Mass. 85, 101 (1983). Actual damages for injuries under 93A comprehend all foreseeable and consequential damages arising out of the conduct which violates the statute. *See Brown v. Le Clair*, 20 Mass. App. Ct. 976, 979 (1985). The Court has not directly addressed whether the insured may recover punitive damages assessed against the insured from the insurer as consequential damages for the insurer's bad faith.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - Massachusetts courts have held that if an insurer desires to control the defense, then it is estopped from disclaiming liability later. However, an insurer may defend under a reservation of rights but must notify the insured of this reservation and may not insist on retaining control of the defense. *Three Sons, Inc. v. Phoenix Ins. Co.*, 357 Mass. 271, 276-77 (1970).

- Can an insurer be held liable for the malpractice or negligence of its appointed defense counsel?

    - Since an insurer is not permitted to practice law, it must rely on independent counsel for conduct if litigation. In doing so, it does not assume a non-delegable duty to present an adequate defense. Since the conduct of the litigation is the responsibility of counsel, the insurer is not vicariously liable for the negligence of the attorney who conducts the defense of its insured. *See Sandman v. Quincy Mutual Fire Ins. Co.*, 81 Mass. App. Ct. 188, 193 (Mass. App. Ct. 2012).

    - The Supreme Judicial Court has cautioned, though, that an insurer could be liable for the malpractice of its counsel retained to defend the interests of the insured, if the insurer directed, commanded, or controlled the defense of the insured. *See Herbert Sullivan, Inc. v. Utica Mutual Ins. Co.*, 439 Mass. 387, 408-10 (2003).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes: Mass. Gen . Laws 93A, section 9; Mass. Gen. Law ch. 176D.

    - A third party claimant can sue a tortfeasor's liability insurer under M.G.L. c.93A §9 for refusing to settle after the insured's liability has become reasonably clear. *Clegg v. Butler*, 424 Mass. 413, 420-24 (1997). Further, where liability has become reasonably clear, the Massachusetts appellate court has recognized that, consistent with the purpose of 176D, § 3(9), to protect the claimants and encourage settlements, an insurer's statutory duty to make a prompt and fair settlement offer does not depend on the willingness of the claimant to accept such an offer. *See Gore v. Arbella Mutual Ins. Co.*, 77 Mass. App. Ct. 518, 529 (Mass. App. Ct. 2010).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No, see First Party analysis above.

    - Subrogation: Massachusetts courts have recognized the right of policyholders to enter into agreements with tort claimants wherein they assign their contractual and bad faith rights in return for an agreement by the plaintiff not to execute upon a judgment against them. *Campione v. Wilson*, 422 Mass. 185, 190-194 (1996), and *Bolden v. O'Connor Café of Worcester, Inc.*, 50 Mass. App. Ct. 56, 59 n. 7 (Mass. App. Ct. 2000).

- What are the applicable statutes of limitations?

    - 4 years after the case accrues. Mass. Gen. Law Ch. 260 §5A (2009).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Either Liability or Damages are not Reasonably Clear: Massachusetts courts have held that an insurer's duty to settle does not arise until liability is reasonably clear and that liability encompasses both fault and damages. *See Clegg v. Butler*, 424 Mass. 413, 421 (1997).

    - Settlement Offer was Reasonable: In order to set forth a defense that the settlement was reasonable one must look to "whether, in the circumstances, and in light of the complainant's demands, the offer is reasonable." *Clegg v. Butler*, 424 Mass. 413, 420 (1997). However, an excessive demand by a plaintiff "do[es] not relieve an insurer of its statutory duty to extend a prompt and equitable offer of settlement once liability and damages are reasonably clear." *Bobick v. United States Fid. & Guar. Trust*, 439 Mass. 652, 662 (2003).

- What are the recoverable damages for the bad faith cause of action?

    - Massachusetts courts have held that in a third party action "single recovery shall be 'the amount of actual damages,' meaning the

(foreseeable) loss to the claimant caused by the violation, this amount to be double or tripled where the violation was in bad faith." *Yeagle v. Aetna Cas. & Sur. Co.*, 42 Mass. App. Ct 650, 653 - 4 (Mass. App. Ct. 1997). *Yeagle* further holds that the damages must be caused by "the unfair practice". *Id.* at 654.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes, damages may be trebled if the violation is done so in bad faith. *Yeagle v. Aetna Cas. & Sur. Co.*, 42 Mass. App. Ct 650, 653-54 (Mass. App. Ct. 1997). Actions subject to multiplication are those that are "knowing or willful or actuated by bad faith." *Yeagle v. Aetna Cas. & Sur. Co.*, 42 Mass. App. Ct 650, 655 (Mass. App. Ct. 1997). Examples of actions that constitute bad faith include: (1) approaching plaintiff after knowledge plaintiff is represented by counsel, *Clegg v. Butler*, 424 Mass. 413 (1997), (2) requiring a release from injured party when liability of insured was clear, *Kapp v. Arbella Mut. Ins. Co.*, 436 Mass. 683, 687 (1998), and (3) making statements known to be false, *Kapp v. Arbella Mut. Ins. Co.*, 436 Mass. 683, 687 (1998). Further, the Court has stated that the 1989 amendment to 93A, § 9(3) makes no distinction between first-party and third-party insurers for any purpose, including calculation of multiple damages.

MICHIGAN

SUMMARY:

- Can an insured sue for bad faith (i.e. first-party bad faith claim)? Yes.

- Can third parties sue for bad faith (i.e. third-party bad faith claim)? No.

FIRST-PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source and its main provisions.

    - Uniform Trade Practices Act, M.C.L. § 500.2001 *et seq.*

        - M.C.L. § 500.2006 (1) provides:

          A person must pay on a timely basis to its insured, an individual or entity directly entitled to benefits under its insured's contract of insurance, or a third party tort claimant the benefits provided under the terms of its policy, or, in the alternative, the person must pay to its insured, an individual or entity directly entitled to benefits under its insured's contract of insurance, or a third party tort claimant 12% interest, as provided in subsection (4), on claims not paid on a timely basis. Failure to pay claims on a timely basis or to pay interest on claims as provided in subsection (4) is an unfair trade practice unless the claim is reasonably in dispute.

        - The Uniform Trade Practices Act does not create a private right of action, but an insured may recover the interest penalty. *Young v. Michigan Mut. Ins. Co.*, 139 Mich. App. 600, 604-06, 362 N.W.2d 844, 846-47 (1984).

- Is there a common law/judicially created bad faith cause of action? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - When an insurer exhibits bad faith by failing to settle a claim on behalf of its insured, resulting in a judgment that exceeds

the policy limits, the insured may sue for bad faith. *See City of Wakefield v. Globe Indem. Co.*, 246 Mich. 645, 648; 225 N.W. 643 (1929) (An insurer "is liable to the insured for an excess of judgment over the face of the policy when the insurer, having exclusive control of settlement, fraudulently or in bad faith refuses to compromise a claim for an amount within the policy limit.").

- The Michigan Supreme Court has declined to recognize a separate tort cause of action for the bad-faith breach of an insurance contract. *See Kewin v. Massachusetts Mut. Life Ins. Co.*, 409 Mich. 401; 295 N.W.2d 50 (1980); *Roberts v. Auto-Owners Ins. Co.*, 422 Mich. 594; 374 N.W.2d 905 (1985); *Gillespie v. Farm Bureau Mut. Ins. Co.*, No. 268649, 2006 WL 2089176 (Mich. Ct. App. 2006).

- The Michigan Supreme Court has defined "bad faith" for instructional use at trial to be "arbitrary, reckless, indifferent, or intentional disregard of the interests of the person owed a duty." *See Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 426 Mich. 127; 393 N.W.2d 161 (1986).

    - But when limited to bad-faith cases involving the Uniform Trade Practices Act, M.C.L. § 500.2006(4), the following "bad faith" definition is applicable: "conscious doing of a wrong because of dishonest purpose or moral obliquity." *See Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 426 Mich. 127, 136 n.5; 393 N.W.2d 161 (1986) (citing *Medley v. Canady*, 126 Mich. App. 739, 748; 337 N.W.2d 909 (1983)).

    - "Good-faith denials, offers of compromise, or other honest errors of judgment are not sufficient to establish bad faith. Further, claims of bad faith cannot be based upon negligence or bad judgment, so long as the actions were made honestly and without concealment. However, because bad faith is a state of mind, there can be bad faith without actual dishonesty or fraud. If the insurer is motivated by selfish purpose or by a desire to protect its own interest, bad faith exists, even though the

insurer's actions were not actually dishonest or fraudulent." *Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 426 Mich. 127, 136-37; 393 N.W.2d 161 (1986).

- What is the applicable statute of limitations?

    - M.C.L. § 600.5807(8). The period of limitations is 6 years for all other actions to recover damages or sums due for breach of contract.

    - *Rory v. Cont'l Ins. Co.*, 473 Mich. 457; 703 N.W.2d 23 (2005) (holding that insurance policies are subject to the same principles that apply to other species of contracts); *Tenneco Inc. v. Amerisure Mut. Ins. Co.*, 281 Mich. App. 429; 761 N.W.2d 846 (2008) (holding that breach of insurance contract claims are essentially breach of contract claims governed by the six-year period of limitations).

- What defenses are available to the bad faith cause of action?

    - Bona-Fide Belief or Mistake of Judgment

        - "'It is not bad faith if counsel for the insurer refuse settlement under the bona fide belief that they might defeat the action, or, in any event, can probably keep the verdict within the policy limit . . . . A mistake of judgment is not bad faith.'" *Frankenmuth Mut. Ins. Co. v. Keeley*, 433 Mich. 525; 447 N.W.2d 691 (1989) (quoting *Wakefield v. Globe Indem. Co.*, 246 Mich. 645; 225 N.W. 643 (1929)).

        - A claim of bad faith cannot be based on negligence or bad judgment if "the actions were made honestly and without concealment." *Miller v. Riverwood Recreation Ctr., Inc.*, 215 Mich. App. 561, 571; 546 N.W.2d 684 (1996) (quoting *Commercial Union Ins. Co. v. Liberty Mut. Ins. Co.*, 426 Mich. 127, 137; 393 N.W.2d 161 (1986)).

- What are the recoverable damages for the bad faith cause of action?

- Where an insurer exhibits bad faith in failing to settle a claim on behalf of its insured, and a judgment results that is in excess of the policy limits, the insurer is liable for the excess amount. *See Frankenmuth Mutual Ins. Co. v. Keeley*, 433 Mich. 525; 447 N.W.2d 691 (1989).

- Where an insurer is liable for failure to defend a claim, it is liable for the amount the insured would be damaged by the breach, which could be the full amount of a default judgment (even in excess of limits), but is limited by the amount of the insured's assets not exempt from legal process, as that is the damage the insured would suffer. In this case the insured assigned his claim to the injured party who sued the insurer. *See generally Stockdale v. Jamison*, 416 Mich. 217; 330 N.W.2d 389 (1982). This decision was limited to cases involving the failure to defend. *Frankenmuth Mutual Ins. Co. v. Keeley*, 433 Mich. 525; 447 N.W.2d 691, 698 fn. 21 (1989).

- Attorney Fees: In Michigan, the recovery of attorney fees incurred as a result of an insurer's bad-faith refusal to pay an insured's claim is governed by the American Rule. The American Rule bars recovery, as consequential damages, of foreseeable attorney fees incurred in enforcing remedies for a breach. Instead, attorney fees are only recoverable when expressly authorized by a statute, court rule, or a recognized exception. *See Burnside v. State Farm Fire and Cas. Co.*, 208 Mich. App. 422, 429-31; 528 N.W.2d 749 (1995).

- M.C.L. § 600.6013 (1)—Statutory Interest

> *Interest shall be allowed on a money judgment recovered in a civil action, as provided in this section. However, for complaints filed on or after October 1, 1986, interest is not allowed on future damages from the date of filing the complaint to the date of entry of the judgment. As used in this subsection, "future damages" means that term as defined in section 6301.*

- M.C.L. § 500.2006(1)—Penalty Interest

> *A person must pay on a timely basis to its insured, an individual or entity directly entitled to benefits under its insured's contract of insurance, or a third party tort claimant the benefits provided under the terms of its policy, or, in the alternative, the person must pay to its insured, an individual or entity directly entitled to benefits under its insured's contract of insurance, or a third party tort claimant 12% interest, as provided in subsection (4), on claims not paid on a timely basis. Failure to pay claims on a timely basis or to pay interest on claims as provided in subsection (4) is an unfair trade practice unless the claim is reasonably in dispute.*

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Exemplary Damages: Absent allegation and proof of tortuous conduct that exists independent of a breach, exemplary damages may not be awarded in breach of commercial contract actions. *See Kewin v. Massachusetts Mut. Life Ins. Co.*, 409 Mich. 401, 420-21; 295 N.W.2d 50 (1980).

- Are punitive damages insurable?

  - Michigan law permits insurance coverage for punitive damage awards. *See Meijer, Inc. v. General Star Idem. Co.*, 826 F. Supp. 241, 246-47 (W.D. Mich. 1993); *Ford Motor Co. v. Northbrook Ins. Co.*, 838 F. 2d 829 (6th Cir. 1988).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - Yes, an insured is permitted to recover punitive damages from an insurer. *See Meijer, Inc. v. General Star Idem. Co.*, 826 F. Supp. 241 (W.D. Mich. 1993); *Ford Motor Co. v. Northbrook Ins. Co.*, 838 F. 2d 829 (6th Cir. 1988). Thus, while no case has directly so

held, it logically follows that punitive damages are recoverable as part of an excess verdict award.

- Does the state follow the *Cumis* case that allows the insured to select counsel in an insurer-insured conflict?

    - Michigan has not adopted a *Cumis* rule. Michigan Insurance Law and Practice ch. 2 (Michael H. Fabian et al. eds., ICLE 2002), *available at* http://www.icle.org/modules/books/chapter.aspx/?lib=business&book=2002551145&chapter=02 (last updated 08/06/2010).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No Michigan case has decided this precise issue. However, in *Atlanta Int'l Ins. Co. v. Bell*, 438 Mich. 512, 475 N.W.2d 294 (1991), the Michigan Supreme Court held that the doctrine of equitable subrogation permits a malpractice action by an insurer against defense counsel that an insurer appointed to defend an insured. In so holding the Court noted that there is no attorney-client relationship between the insurer and defense counsel, whose client is the insured, and sometimes conflicts can arise between the defense counsel and insurer as to case handling. Thus, it seems likely that the Court would not hold the insurer liable for the defense counsel's malpractice.

THIRD-PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source and its main provisions.

    - No, see discussion above re first-party bad faith.

    - M.C.L. § 500.3030 Insurer not to be made or joined as party defendant; reference to insurer or insurance during trial.

In the original action brought by the injured person, or his or her personal representative in case death results from the accident, as mentioned in section 3006, the insurer shall not be made or joined as a party defendant, nor, except as otherwise provided by law, shall any reference whatever be made to such insurer or to the question of carrying of such insurance during the course of trial.

- Is there a common law/judicially created bad faith cause of action? If so, identify the major case(s) and language of the standards applicable to bad faith cases.
    - No.

MISSISSIPPI

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes. Seminal case is *Standard Life Ins. Co. v. Veal*, 354 So.2d 239 (Miss. 1978).

- Can third parties sue for bad faith (i.e., third party bad faith)? No. See *Davidson v. Davidson*, 667 So.2d 616, 621-22 (Miss. 1995); *Myers v. Mississippi Farm Bureau Mut. Ins. Co.* (Miss. Ct. App. 1999) 749 So.2d 1173, 1174.

FIRST PARTY BAD FAITH

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Miss. Code Ann. § 83-5-45: Gives the Commissioner the right to bring claims against insurance companies for unfair business practices

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Independent cause of action for bad faith as a tort: *Universal Life Ins. Co. v. Veasley*, 610 So.2d 290 (Miss. 1992)

    - Implied Covenant of Good Faith and Fair Dealing: *Stewart v. Gulf Guar. Life Ins. Co.*, 846 So.2d 192, 201 (Miss. 2002); *Andrew Jackson Life Ins. Co. v. Williams*, 566 So.2d 1172, 1188-89 (Miss. 1990)

- What are the applicable statutes of limitations?

    - Three years. *Oak v. Sellers*, 953 So.2d 1077, 1084 (Miss. 2007) (applying Miss. Code Ann. § 15-1-49)

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Legitimate Question of Liability on Claim (arguable reason for denial or delay): *Windmon v. Marshall*, 926 So.2d 867, 872 (Miss. 2006); *Liberty Mut. Ins. Co. v. McKneely*, 862 So.2d 530, 533 (Miss. 2003); *State Farm Mut. Auto. Ins. Co. v. Grimes*, 722 So.2d 637, 641 (Miss. 1998); *Murphree v. Federal Ins. Co.*, 707 So.2d 523, 529 (Miss. 1997)

- What are the recoverable damages for the bad faith cause of action?

    - The full measure of the reasonably foreseeable consequences of the insurer's acts: *Universal Life Ins. Co. v. Veasley*, 610 So.2d 290 (Miss. 1992)

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Mississippi has a number of punitive damage cases with very high verdicts.

    - See discussion in *Sessums v. Northtown Limousines, Inc.*, 664 So.2d 164, 169-170 (Miss. 1995) (punitives upheld unless "so excessive that it evinces passion, bias and prejudice on the part of the jury so as to shock the conscience of the court"); see also *United American Ins. Co. v. Merrill*, 978 So.2d 613 (Miss. 2007) (award of $900,000 not excessive where less than 5 times compensatory damages and less than one-half of one percent of net worth); *American Income Life Ins. Co. v. Hollins*, 830 So.2d 1230, (Miss. 2002) (punitives of $100,000 not constitutionally excessive, even though 250 times the compensatory damages of $400, where the insurer was a corporation with a net worth of over $63 million).

    - Law requires a finding of "bad faith plus", based on a preponderance of the evidence, before punitive damages may be awarded. *Andrew Jackson Life Ins.Co. v. Williams*, 566 So.2d 1172, 1188-89 (Miss. 1990).

- Punitive damages are available for breaches of insurance policies attended by (1) lack of an arguable or legitimate basis for denial or delay and (2) a willful or malicious wrong, or action with gross or reckless disregard for the insured's rights. *Jenkins v. Ohio Cas. Ins. Co.*, 794 So.2d 228, 232-33 (Miss. 2001) (citing *State Farm Mut. Auto Ins. Co. v. Grimes*, 722 So.2d 637, 641 (Miss. 1998); *Life & Cas. Ins. Co. v. Bristow*, 529 So.2d 620, 622 (Miss. 1988); see also *Murphree v. Fed. Ins. Co.*, 707 So.2d 523 (Miss. 1997) (even if insurer lacks reasonable basis for denial, punitive damages can be sought only if the insurer acted with malice, gross negligence, or reckless disregard for the insured's rights)

- Are punitive damages insurable?

  - *Anthony v. Frith*, 394 So.2d 867 (Miss. 1981), held that it is not against public policy to insure against punitive damages.

- Can punitive damages, assessed against the insured after the insurer fails to settle, be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - *Anthony v. Frith*, 394 So.2d 867 (Miss. 1981), was an action by a judgment creditor who was awarded both compensatory and punitive damages; the Supreme Court held that the insurer had to honor both awards.

  - *Kaplan v. Harco Nat. Ins. Co.*, 716 So.2d 673 (Miss. App. 1998), permitted an insured to assign a claim against its insurer for punitive damages to a judgment creditor.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - Yes. *Moeller v. American Guar. and Liability Ins. Co.*, 707 So.2d 1062 (Miss. 1996) (Insurer defended law firm under reservation of rights because only one claim alleged in Complaint was covered. This created a conflict of interest; thus the insurer was obligated to let the law firm select its own attorney to represent it at the insurer's cost.)

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

- Uncertain, but Mississippi appears to lean toward such a conclusion. *Hartford Acc. & Indem. Co. v. Foster*, 528 So. 2d 255 (Miss. 1988), distinguished between claims of attorney negligence, and claims based on defense counsel's breach of fiduciary duty owed to the insured. In the latter case, the Court said the carrier can be liable. In dicta the court cited *Smoot v. State Farm Mutual Auto Ins. Co.*, 299 F.2d 525, 530 (5th Cir. 1962), for the proposition that chosen defense counsel are the insurer's "agents for whom it has the customary legal liability." *Foster* was later cited for the holding that legal malpractice claims may be based upon either a violation of the standard of care, or upon the breach of a fiduciary duty. *Wilbourn v. Stennett, Wilkinson & Ward*, 687 So.2d 1205 (Miss. 1996).

THIRD PARTY BAD FAITH

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Miss. Code Ann. § 83-5-45: Gives the Commissioner the right to bring claims against insurance companies for unfair business practices

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. See *Davidson v. Davidson*, 667 So.2d 616, 621-22 (Miss. 1995) (beneficiary of life insurance policy was the only person with a legal interest in the policy who could sue for bad faith).

    - See also *Myers v. Mississippi Farm Bureau Mut. Ins. Co.* (Miss. Ct. App. 1999) 749 So.2d 1173, 1174 ("The insurance policy was between the Bews and Farm Bureau. Myers is a third-party who is not privy to the contract between the Bews and Farm Bureau. Myers, therefore, cannot maintain an action of bad faith against Farm Bureau.").

MISSOURI

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes*
- Can third parties sue for bad faith (i.e., third party bad faith)? No

*Missouri's law of "bad faith" is premised upon distinction between coverage types, i.e. "first party" coverage such as fire, wind, hail and uninsured motorist for which the insured hopes to collect the policy proceeds for their own benefit and "third party" liability coverage such as commercial general liability and personal automobile liability for which the policy proceeds are ultimately recovered by a third party. Missouri has enacted two statutes which control "first party" claims and which preempt any common law claims for "bad faith" arising from first party coverage. However, Missouri does allow for common law "bad faith" claims in cases arising from the insurer's failure to settle a liability claim against its insured within the insured's policy limit. Although such actions must be filed by the insured or in the insured's name, they are commonly referenced throughout Missouri law as claims for "third-party" bad faith. *See Duncan v. Andrew County Mut. Ins. Co.,* 665 S.W.2d 13, 18-19 (Mo. Ct. App. 1983).

FIRST PARTY BAD FAITH

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.
    - Since it is preempted by statute, the tort of bad faith does not exist in Missouri with respect to first-party claims by an insured against an insurance company. Nevertheless, an insured can bring a cause of action for vexatious refusal to pay under Missouri Revised Statutes Sections 375.296 and 375.420.
    - These statutes provide the insured a right to assert a cause of action for damages, in addition to breach of contract damages, when the insurer has not complied with the terms of the applicable statute.

- **Section 375.296**, Additional Damages for Vexatious Refusal to Pay, states:

> *. . . if the insurer has failed or refused for a period of thirty days after due demand therefor prior to the institution of the action, suit or proceeding, to make payment under and in accordance with the terms and provisions of the contract of insurance, and it shall appear from the evidence that the refusal was vexatious and without reasonable cause, the court or jury may, in addition to the amount due under the provisions of the contract of insurance and interest thereon, allow the plaintiff damages for vexatious refusal to pay and attorney's fees as provided in Section 375.420. Failure of an insurer to appear and defend any action, suit or other proceeding shall be deemed prima facie evidence that its failure to make payment was vexatious without reasonable cause*.

Section 375.420, Vexatious Refusal to Pay Claim, Damages for, Exception, states:

> *In any action against any insurance company to recover the amount of any loss under a policy . . . if it appears from the evidence that such company has refused to pay such loss without reasonable cause or excuse, the court or jury may, in addition to the amount thereof and interest, allow the plaintiff damages <u>not to exceed twenty percent of the first fifteen hundred dollars of the loss, and ten percent of the amount of the loss in excess of fifteen hundred dollars and a reasonable attorney's fee</u>; and the court shall enter judgment for the aggregate sum found in the verdict*.

- In order to sustain an award under these statutes, "(the) plaintiff must show that the insurer's refusal to pay the loss was willful and without reasonable cause, as the facts would appear to a reasonable and prudent person before trial." *Dewitt v. American Family Mut. Ins. Co*., 667 S.W.2d 700, 710 (Mo. 1984).

- Furthermore, a plaintiff's verdict for the policy proceeds is not sufficient evidence in and of itself to warrant vexatious refusal penalties. "Vexatious refusal to pay is not to be deduced from the mere fact that upon trial the verdict is adverse to defendant. The

word 'vexatiously', as used in the statute, Section 375.420 R.S.Mo. 1949, V.A.M.S., means without reasonable or probable cause or excuse." *Pfingsten v. Franklin Life Ins. Co.*, 330 S.W.2d 806, 817 (Mo. 1959).

- The Missouri Supreme Court has provided guidance in determining whether evidence supports an award for vexatious refusal:

> The existence of a litigable issue, either factual or legal, does not preclude a vexatious penalty where there is evidence the insurer's attitude was vexatious and recalcitrant. Direct and specific evidence to show vexatious refusal is not required(;) the jury may find vexatious (delay) upon a general survey and a consideration of the whole testimony and all the facts and circumstances in connection with the case.

Dewitt v. American Family Mut. Ins. Co., 667 S.W.2d 700, 710 (Mo. 1984).

- The burden of proof is on the insured, and the vexatious refusal statutes, being penal in nature, must be strictly construed. *Katz Drug Co. v. Commercial Standard Ins. Co.*, 647 S.W.2d 831, 840 (Mo. Ct. App. 1983).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - The implied covenant of good faith is recognized– but it does not appear to be a separate cause of action from breach of contract. However, an insurer may be liable for separate torts that occur during the claim handling process, e.g. defamation. *Overcast v. Billings Mut. Ins. Co.*, 11 S.W.3d 62 (Mo. 2000).

  - See below, under Third Party Bad Faith, the discussion of the claim for failure to settle.

- What are the applicable statutes of limitations?

    - 5 years -- Missouri Revised Statutes Section 516.120.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Missouri Revised Statutes Section 375.296 requires a showing that the insurance company's "refusal (to pay) was vexatious without reasonable cause." Likewise, Missouri Revised Statutes Section 375.420 requires a showing that the insurance company "has refused to pay such loss without reasonable cause or excuse." Discussed below are defenses that courts have recognized and made available to insurance companies in vexatious refusal to pay cases.

    - Reasonable Cause or Excuse – this is an element of the plaintiff's cause of action, thus it is technically not a defense. Nevertheless, an insurer can escape liability by showing that it had either a reasonable cause or excuse for its refusal to pay. Examples:

        - An insurer has the right to refuse payment and defend a suit so long as it has reasonable grounds to believe its defense is meritorious. *State ex rel. John Hancock Mut. Life Ins. Co. v. Hughes*, 152 S.W.2d 132, 134 (Mo. 1941). However, if the insurer is aware that no such grounds exist and persists in its refusal to pay the policy, then it becomes subject to penalties for vexatious delay.

        - An insurer may ask for a judicial determination of its liability without becoming subject to a vexatious delay penalty for good faith contest of the claim. *Howard v. Aetna Life Ins. Co.,* 164 S.W.2d 360, 366 (Mo. 1942). An honest difference of opinion as to the extent of liability is allowed. *Id.* An insurer will not be penalized for insisting, in good faith, on a judicial determination of open questions of fact or law determinative of the issue of liability. *Cohen v. Metropolitan Life Ins. Co.*, 444 S.W.2d 498, 506 (Mo. Ct. App. 1969) (such as disputes over the proximate cause of an

insured's death and the appropriate statute of limitations to apply).

- In some situations, the law is unsettled, and, the insurer has no way of ascertaining the extent of liability, so penalties for vexatious refusal to pay won't be imposed.

- Contract Defenses – before any vexatious refusal claim can succeed, coverage must first be found to exist under the policy. Since the insurance policy is a contract between the insurer and the insured, an insurer may be able to escape liability for its refusal to pay based on defenses applicable to general contract law.

- Limited advice of counsel defense–But the insurer may not invoke the defense if it failed to inform counsel of all the facts before receiving his advice. *Douglas v. U.S. Fidelity & Guaranty Co.*, 81 N.H. 371, 373 (1924).

- If an insurance plan satisfies the statutory requirements, a claim against the insurance company under the Missouri vexatious refusal to pay statute is preempted by the Employment Retirement Income Security Act (ERISA).

- What are the recoverable damages for the bad faith cause of action?

  - Both vexatious delay statutes permit the court or jury to award damages and/or attorney's fees in addition to any amount due under the contract (Section 375.296) or the loss (Section 375.420).

  - The vexatious refusal to pay statute provides in pertinent part:

    (T)he court or jury may, in addition to the amount thereof and interest, allow the plaintiff damages not to exceed twenty percent of the first fifteen hundred dollars of the loss, and ten percent of the amount of the loss in excess of fifteen hundred dollars and a reasonable attorney's fee; and the court shall enter judgment for the aggregate sum found in the verdict.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

- Although vexatious damages and attorney fees are punitive in character, the measure of damages recoverable in vexatious refusal to pay actions is limited to the amount of loss, interest, statutory penalty of specified percentage of loss, and reasonable attorney's fees. Therefore, plaintiff's punitive damage award or statutory penalty is limited to the amount allowed by the vexatious refusal to pay statute. *Baker v. State Farm Mut. Auto. Ins. Co.*, 846 F.2d 495, 497 (8th Cir. 1988). It should be noted, however, a claim for vexatious refusal to pay may survive the breach of contract (policy) on which it is based. *Dyhne v. State Farm Fire & Cas. Co.*, 188 S.W.3d 454 (Mo. 2006).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - See discussion above regarding First Party Bad Faith.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Missouri courts recognize and impose upon the insurer the duty of acting in "good faith" when handling claims against the insured. This duty is based on the "fiduciary relationship" between an insurer and its insured, in a third-party claim. *Shobe v. Kelly*, 279 S.W.3d 203, 209 (Mo. Ct. App. 2009) (citing *Zumwalt v. Utilities Insurance Co.*, 360 Mo. 362, 228 S.W.2d 750 (Mo. 1950).

    - Generally, the elements of a <u>bad faith refusal to settle</u> claim are set forth in *Dyer v. General American Life Insurance Co.*, 541 S.W.2d 702, 704 (Mo. Ct. App. 1976); *see also Rinehart v. Shelter Gen. Ins. Co.*, 261 S.W.3d 583 (Mo. Ct. App. 2008).

        1. The liability insurer has assumed control over negotiations, settlement, and legal proceedings brought against the insured;

2. The insured has demanded that the insurer settle the claim brought against the insured;

3. The insurer refuses to settle the claim within the liability limits of the policy; and

4. In so refusing, the insurer acts in bad faith, rather than negligently.

However, one or more of these "elements" may not be required for an insured to make a submissible case for "bad faith," under certain circumstances. For instance, where the insurer has unjustly declined coverage, or issued a reservation of rights that is rejected by the insured, the insured may not have to show the first element enumerated above. *Landie v. Century Indem. Co.*, 390 S.W.2d 588, 564-565 (Mo. Ct. App. 1965). Similarly, where an insurer fails to inform its insured about opportunities to settle a third-party claim, the insured does not have to demand that the insurer settle the claim as required by the second element. *Ganaway v. Shelter Mut. Ins. Co.*, 795 S.W.2d 554 (Mo. Ct. App. 1990).

- Determining the final element, i.e. whether the insurer has acted in "bad faith" is a question for the trier of fact that must be decided with reference to the totality of the circumstances. *Ganaway v. Shelter Mut. Ins. Co.*, 795 S.W.2d 554, 562 (Mo. Ct. App. 1990). In order to recover, there must be a showing of bad faith, not just negligence. *Zumwalt v. Utilities Ins. Co.*, 228 S.W.2d 750, 753 (Mo. 1950). Facts that may indicate bad faith by the insurer include:
  - Attempts to escape obligations under the policy by an intentional disregard of the financial interests of the insured;
  - Attempts to force the insured to contribute money to a settlement within the limits of the policy;
  - A preference to gamble on escaping all liability by a favorable verdict rather than accepting a reasonable settlement;
  - Failing to foresee a probable excess verdict;
  - Following advice not to settle or ignoring settlement advice;
  - Failing to advise the insured about the extent of policy coverage;
  - Improperly investigating or evaluating a claim;

        - Failing to advise the insured about the potential for an excess judgment;
        - Failing to advise the insured about the existence of settlement offers;
        - Failing to take preventative action allowing the insured to be held harmless; and
        - Taking a hard-line settlement approach.

    - Third parties do not have the right to sue for bad faith. However, one area of the law of "bad faith" in Missouri relates to the issue of assignability. Due to the fiduciary nature of the duty owed by a liability insurer to its insured, the tort of "bad faith failure to settle" in Missouri is a "personal" tort. The relationship has been analogized to the attorney-client relationship. *Grewell v. State Farm,* 102 S.W.3d 33 (Mo. 2003). Since legal professional negligence cases are not assignable as against public policy, it has been suggested that "bad faith" claims likewise may not be assigned. *See e.g. Johnson v. Allstate*, 262 S.W.3d 655 (Mo. Ct. App. 2008) (J. Smart, concurring), *but see Ganaway*, *supra* (a bad faith claim is assignable by a bankruptcy trustee where the insured has declared bankruptcy).

- What are the applicable statutes of limitations?

    - Typically, actions based on insurance contracts are governed by a ten-year statute of limitations. Missouri courts treat bad faith failure to settle as an action in tort, not in contract. Thus, bad faith actions are governed by the five-year statute of limitations applicable to torts. Mo. Rev. Stat. § 516.120.4 (1994); *State ex rel. Lumbermens Mut. Cas. Co. v. Stubbs*, 471 S.W.2d 268 (Mo. 1971) (applying Mo Rev Stat 516.120 in a third-party case).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - The defenses listed under first-party bad faith are also applicable to third-party suits. The following defenses also may be available in <u>third-party bad faith failure to settle</u> actions:

- Good faith: "where the company in good faith believes there is a valid defense to the claim, even though the defense proves unsuccessful and results in a judgment against the insured above the policy limits, the company is not liable, because of such honest mistake, beyond the limits of its policy." *Landie v. Century Indem. Co*., 390 S.W.2d 558, 563 (Mo. Ct. App. 1965) (citing *Zumwalt v. Utilities Ins. Co*., 228 S.W.2d 750 (Mo. 1950). Good faith requires an insurer to settle within the policy limits as its honest judgment and discretion dictates.

- If an insured does not perform the conditions of the liability contract, then the insurer may be released from liability under the policy for the particular casualty in question (i.e. fails to cooperate), however the insurer must show it has been materially prejudiced by the breach.

- If the claimant does not offer to settle within the policy limits, the Insurer cannot be guilty of bad faith failure to settle, i.e. the insurer's duty is to settle when presented with the opportunity to do so.

- Advice of counsel (to prove the insurer acted reasonably). However, this defense is not available if the insurer knew or had reason to know that the advice was incorrect.

- What are the recoverable damages for the bad faith cause of action, i.e. bad faith refusal to settle?

    - The insurer is liable for the entire judgment against the insured, including the portion of the award that is in excess of the policy limits, and may be liable for additional, intangible "tort" damages, e.g. damages for emotional distress, damage to reputation or damage to credit, and punitive damages. *Shobe v. Kelly*, 279 S.W.3d 203, 212-13 (Mo. Ct. App. 2009)

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

- Yes, punitive damages are recoverable for bad faith failure to settle. *Shobe v. Kelly*, 279 S.W.3d 203, 212-13 (Mo. Ct. App. 2009).

- "A punitive damages award requires more than the showing for bad faith. *Zumwalt*, 228 S.W.2d at 756. The plaintiff must present 'clear and convincing evidence that the defendant's conduct was outrageous because of evil motive or reckless indifference.' *Rinehart v. Shelter Gen. Ins. Co*., 261 S.W.3d 583, 596-97 (Mo. Ct. App. 2008). **"**Clear and convincing evidence establishes the character of the defendant's actions to a 'high probability.'"

  Shobe v. Kelly, 279 S.W.3d 203, 212-13 (Mo. Ct. App. 2009)

- Are punitive damages insurable?

  - No, punitive damages are not insurable in Missouri, except perhaps under certain policies covering public officials. *Heartland Stores, Inc. v. Royal Ins. Co.*, 815 S.W.2d 39, 42-43 (Mo. Ct. App. 1991); *Schnuck Markets, Inc. v. Transamerica Ins*., 652 S.W.2d 206 (Mo. Ct. App.1983); *Crull v. Gleb*, 382 S.W.2d 17 (Mo. Ct. App.1964).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - There is no decision on point, but in *Johnson v. Allstate Ins. Co*., 262 S.W.3d 655, 660 (Mo. Ct. App. 2008), the trial court allowed evidence of the punitive damages from the underlying judgment in the bad faith trial. The total underlying judgment was $5.0MM and the compensatory award in the punitive case was $5.8MM, so it is likely the jury awarded punitive damages against Allstate based on an uncovered punitive award. Allstate did not appeal that evidentiary issue or the submission of the underlying punitive damage award as an element of the insured's "bad faith" damages.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - There is no right to "Cumis" counsel per se.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - This issue has not been decided in Missouri. Such an action was attempted in *Heartland Stores, Inc. v. Royal Ins. Co.*, 815 S.W.2d 39, 40 (Mo. Ct. App. 1991), but the Court sidestepped the legal issue.

    - Our case law would suggest, however, that no such cause of action exists. In Missouri an insurer must retain outside counsel to defend its insured in any case where there is a coverage issue or potential for an excess judgment. This is to ensure the independence of defense counsel to act just as if he had been retained by the insured, directly. "'The obligations of an attorney to his client "are in no way abridged by the fact that an insurer employs him to represent an insured.' The attorney owes the insured the same obligation of good faith and fidelity as if the insured had retained the attorney personally and at his own expense. "*Arana v. Koerner*, 735 S.W.2d 729, 733-34 (Mo. Ct. App. 1987) (overruled on other grounds, *Klemme v. Best*, 941 S.W.2d 493 (Mo. 1997)). The separation of defense counsel and carrier would seem to defeat any claim that the attorney's negligence should be imputed to the carrier. Further, "bad faith" in Missouri requires a show of "more than negligence." *Dyer v. General American Life Insurance Co.*, 541 S.W.2d 702, 704 (Mo. Ct. App. 1976).

ADDITIONAL CITES:
BFA § 2:15 Bad faith at large among the states
62 MOLR 807 – Overview of Bad Faith Litigation in Missouri

MONTANA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.
- Can third parties sue for bad faith (i.e., third party bad faith)? Yes.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.
    - Yes. M.C.A § 33-18-201 prohibits an enumerated list of unfair claim settlement practices. M.C.A. § 33-18-242 creates an independent cause of action for subsections (1), (4), (5), (6), (9), and (13) of M.C.A. § 33-18-201.
    - **M.C.A. § 33-18-201. Unfair claim settlement practices prohibited.**

      A person may not, with such frequency as to indicate a general business practice, do any of the following:

      (1) misrepresent pertinent facts or insurance policy provisions relating to coverages at issue;

      (2) fail to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;

      (3) fail to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;

      (4) refuse to pay claims without conducting a reasonable investigation based upon all available information;

      (5) fail to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;

      (6) neglect to attempt in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably

clear;

(7) compel insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by the insureds;

(8) attempt to settle a claim for less than the amount to which a reasonable person would have believed the person was entitled by reference to written or printed advertising material accompanying or made part of an application;

(9) attempt to settle claims on the basis of an application that was altered without notice to or knowledge or consent of the insured;

(10) make claims payments to insureds or beneficiaries not accompanied by statements setting forth the coverage under which the payments are being made;

(11) make known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;

(12) delay the investigation or payment of claims by requiring an insured, claimant, or physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;

(13) fail to promptly settle claims, if liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage; or

(14) fail to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

- **M.C.A. § 33-18-242. Independent cause of action -- burden of proof.**

(1) An insured or a third-party claimant has an independent cause of

action against an insurer for actual damages caused by the insurer's violation of subsection (1), (4), (5), (6), (9), or (13) of 33-18-201.

(2) In an action under this section, a plaintiff is not required to prove that the violations were of such frequency as to indicate a general business practice.

(3) An insured who has suffered damages as a result of the handling of an insurance claim may bring an action against the insurer for breach of the insurance contract, for fraud, or pursuant to this section, but not under any other theory or cause of action. An insured may not bring an action for bad faith in connection with the handling of an insurance claim.

(4) In an action under this section, the court or jury may award such damages as were proximately caused by the violation of subsection (1), (4), (5), (6), (9), or (13) of 33-18-201. Exemplary damages may also be assessed in accordance with 27-1-221.

(5) An insurer may not be held liable under this section if the insurer had a reasonable basis in law or in fact for contesting the claim or the amount of the claim, whichever is in issue.

(6) (a) An insured may file an action under this section, together with any other cause of action the insured has against the insurer. Actions may be bifurcated for trial where justice so requires.

(b) A third-party claimant may not file an action under this section until after the underlying claim has been settled or a judgment entered in favor of the claimant on the underlying claim.

(7) The period prescribed for commencement of an action under this section is:

(a) for an insured, within 2 years from the date of the violation of 33-18-201; and

(b) for a third-party claimant, within 1 year from the date of the settlement of or the entry of judgment on the underlying claim.

(8) As used in this section, an insurer includes a person, firm, or corporation utilizing self-insurance to pay claims made against them.

- As respects insureds, the insurers duty to effect settlement under M.C.A § 33-18-201(6) is a fiduciary duty. *Lorang v. Fortis Ins. Co.*, 345 Mont. 12, 62, 192 P.3d 186, 221 (2008).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Yes, but only for claims not included in M.C.A. § 33-18-242.

  - "§ 33-18-242(3), MCA, explicitly prohibits bringing an action for bad faith in connection with the handling of an insurance claim." *Dees v. American Nat'l Fire Ins. Co.*, 260 Mont. 431, 450, 861 P.2d 141 (Mont. 1993).

  - However, the insured may bring a common law bad faith claim against an insurer for pre-claim conduct, such as bad faith conduct that occurs during the application and underwriting process. *Williams v. Union Fid. Life Ins. Co.*, 329 Mont. 158, 176, 123 P.3d 213 (Mont. 2005).

  - Montana courts have held that an insurer may be liable for common law bad faith for failing to disclose a policy change during renewal to the insured's detriment. *Thomas v. Northwestern Nat'l Ins. Co.*, 292 Mont. 357, 369-70, 973 P.2d 804 (Mont. 1998).

  - The insured may only bring a common law bad faith claim where there is a "special relationship" between the parties. The insured must prove a "special relationship" via the following five-part test: "(1) the contract must be such that the parties are in inherently unequal bargaining positions; [and] (2) the motivation for entering the contract must be a non-profit motivation, i.e., to secure peace of mind, security, future protection; [and] (3) ordinary contract damages are not adequate because (a) they do not require the party in the superior position to account for its actions, and (b) they do not make the inferior party 'whole'; [and] (4) one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform; and (5) the

other party is aware of this vulnerability." *Thomas v. Northwestern Nat'l Ins. Co.*, 292 Mont. 357, 367-68, 973 P.2d 804 (Mont. 1998) (citation omitted).

- What are the applicable statutes of limitations?
    - Statutory claims: Within two years from the date of the violation. M.C.A. § 33-18-242(7)(a).
    - Common law claims: Within three years. M.C.A. § 27-2-204(1). The period of limitations begins to run "when the claim or cause of action accrues." M.C.A. § 27-2-102(2).
- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?
    - "An insurer may not be held liable under this section if the insurer had a reasonable basis in law or fact for contesting the claim or the amount of the claim, whichever is in issue." M.C.A. § 33-18-242(5).
        - *Graf v. Continental West Ins. Co.*, 321 Mont. 65, 89 P.2d 22 (2004), held that a defense verdict in the liability case does not establish as a matter of law that the insurer had a reasonable basis for contesting a claim. In *Graf*, the insured obtained a defense verdict and then the case was settled on appeal. The settlement was a satisfactory prerequisite for the bad faith action.
    - An insurer may challenge a claim based upon debatable law or facts without incurring liability for bad faith, provided its position is not wholly unsupportable. *Safeco Ins. Co. v. Ellinghouse*, 223 Mont. 239, 248, 725 P.2d 217 (Mont. 1986).
- What are the recoverable damages for the bad faith cause of action?
    - M.C.A. § 33-18-242 (4) allows an award of "such damages as were proximately caused by the violation of subsection (1), (4), (5), (6), (9), or (13) of 33-18-201."
    - Emotional distress damages may also be awarded. *See, e.g., Stephens v. Safeco Ins. Co. of America*, 258 Mont 142, 852 P.2d 565 (Mont. 1993).

- Attorney fees are generally not recoverable, as they are not provided for in the statute. *Sampson v. Nat'l Farmers Union Prop & Cas. Co.*, 333 Mont. 541, 547-48, 144 P.2d 797 (Mont. 2006).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. M.C.A. § 33-18-242(4) authorizes recovery of exemplary damages in accordance with M.C.A. § 27-1-221.

  - To recover punitive damages, the insured must prove actual fraud or actual malice by clear and convincing evidence. M.C.A. § 27-1-221(1) and (5).

    - "Clear and convincing evidence means evidence in which there is no serious or substantial doubt about the correctness of the conclusions drawn from the evidence. It is more than a preponderance of evidence but less than beyond a reasonable doubt." M.C.A. § 27-1-221(5).

- Are punitive damages insurable?

  - Directly assessed punitive damages are insurable in Montana in certain circumstances. *See First Bank (N.A.)-Billings v. Transamerica Ins. Co.*, 679 P.2d 1217 (Mont. 1984); *Fitzgerald v. Western Fire Ins. Co.*, 679 P.2d 790 (Mont. 1984) (finding that punitive damages for negligently driving an auto and causing injuries are insurable). However, in *Smith v. State Farm Ins. Co.*, 870 P.2d 74 (Mont. 1994), the court held that public policy prohibits indemnifying willful misconduct. *See also* Mont. Code Ann. § 33-15-317 (2003) (insurance does not cover punitive damages unless expressly included in the contract).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - This issue has not been specifically addressed by Montana courts; however, courts have found an insurer liable for the amount of an excess verdict without distinguishing between the compensatory damages and punitive damages awarded in the underlying case. *See Goettel v. Estate of Ballard*, 356 Mont. 527, 234 P.3d 99 (Mont.

2010); *Shilhanek v. D-2 Trucking, Inc.*, 315 Mont. 519, 70 P.3d 721 (Mont. 2003); *Watters v. Guaranty Nat. Ins. Co.*, 300 Mont. 91, 3 P.3d 626 (Mont. 2000) (overruled on other grounds); *Gibbes v. Western Fire Ins. Co.*, 210 Mont. 267, 682 P.2d 725 (1984) ("It is now fairly established in American jurisprudence that an insurer which in bad faith fails to settle a bona fide third party liability claim against its insured, within policy coverage limits, takes the risk of a judgment by the trier of fact in excess of the coverage limits. The effect of such bad faith is to open the policy coverage limits to the extent of the trial result.").

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - The insured is the sole client of defense counsel, whether there is a present conflict of interest between the insured and the insurer's interests or not. *In the Matter of the Rules of Professional Conduct and Insurer Billing Rules and Procedures*, 299 Mont 321, 333, 2 P.3d 806 (2000).

    - In addition, detailed billing statements may not be disclosed to third-party auditors without the insured's fully informed consent. *Id.* at 347.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No. *Peterson v. St. Paul Fire & Marine Ins. Co.*, 357 Mont. 293, 312-13, 239 P.3d 904 (Mont. 2010); *In re Rules of Prof'l Conduct & Insurer Imposed Billing Rules & Procedures*, 299 Mont. 321, 2 P.3d 806 (Mont. 2000).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. M.C.A. § 33-18-242 also provides a cause of action for third-party claimants, but "[a] third-party claimant may not file an action under this section until after the underlying claim has been

settled or a judgment entered in favor of the claimant on the underlying claim." M.C.A. § 33-18-242(6)(b).

- *Kaudt v. Flink*, 202 Mont. 247, 252, 658 P.2d 1065, 1067 (1983), superseded in part by M.C.A. § 33-18-242 (M.C.A § 33-18-201(6) creates private right of action in injured claimants).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.
  - Yes. "§33-18-242, MCA does not prohibit a third-party claimant from bringing an action for common law bad faith." *Brewington v. Employers Fire Ins. Co*., 297 Mont. 243, 248, 992 P.2d 237 (Mont. 1999).

- What are the applicable statutes of limitations?
  - Statutory claims: "[W]ithin 1 year from the date of the settlement of or the entry of judgment on the underlying claim." M.C.A. § 33-18-242(7)(b).
  - Common law claims: Within three years. M.C.A. § 27-2-204(1). *Brewington v. Employers Fire Ins. Co*., 297 Mont. 243, 249, 992 P.2d 237, 241 (Mont. 1999). The period of limitations begins to run "when the claim or cause of action accrues." M.C.A. § 27-2-102(2).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?
  - Same as first-party claims. *See* M.C.A. § 33-18-242(5)

- What are the recoverable damages for the bad faith cause of action?
  - Same as first-party claims. *See* M.C.A. § 33-18-242(4)

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?
  - Yes. Same as first-party claims. M.C.A. § 33-18-242(4) authorizes recovery of exemplary damages in accordance with M.C.A. § 27-1-221.

NEBRASKA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No, except in limited circumstances.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Insurance companies are regulated by the Unfair Insurance Trade Practices Act, Neb. Rev. Stat. § 44-1501 et. seq.

        - "Neb.Rev.Stat. ss 44-1522 et seq. does not contemplate private suits but instead only vests powers and duties in the state Director of Insurance, who is empowered to enjoin and penalize certain prohibited acts. . . ." *Allied Fin. Servs., Inc., v. Foremost Ins. Co.*, 418 F. Supp. 157, 162 (D. Neb. 1976).

    - Unfair Claims Handling is regulated by Neb. Rev. Stat. § 44-1525(9)

    - Unfair Claims Settlement Practices is regulated by Neb. Rev. Stat. § 44-1540

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. Under Nebraska law, to establish bad faith an insured must prove (1) the absence of a reasonable basis for denial of coverage, and (2) the insurer's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. *LeRette v. American Medical Sec., Inc.*, 705 N.W.2d 41, 43 (Neb. 2005); *see also Braesch v. Union Ins. Co.*, 464 N.W.2d 769, 777 (Neb. 1991) [*disapproved on other grounds*].

- Knowledge or reckless disregard can be inferred and imputed from the insurer's failure to conduct a proper investigation and subject the results to a reasonable evaluation and review. *Ruwe v. Farmers United Mut. Ins. Co.*, 469 N.W.2d 129, 135 (Neb. 1991); *Weatherly v. Blue Cross Blue Shield Ins. Co.*, 513 N.W.2d 347, 355 (Neb. Ct. App. 1994).

- Nebraska recognizes the tort cause of action for insurer bad faith in refusing to settle a claim with a third party. *Olson v. Union Fire Ins. Co.,*118 N.W.2d 318 (Neb. 1962). The rationale for the rule is that "[i]n the event the insurer elects to resist a claim of liability, or to effect a settlement thereof on such terms as it can get, there arises an implied agreement that it will exercise due care and good faith where the rights of an insured are concerned." *Id.*at 321.

- The rationale for the rule has been explained in terms of there being a fiduciary relationship between the insured and insurer. *Braesch v. Union Ins. Co.*, 464 N.W.2d 769, 772-73 (Neb. 1991) [*disapproved on other grounds*].

- What are the applicable statutes of limitations?

  - 5 years for "actions on written contracts." Neb.Rev.Stat. § 25-205.

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - If the insurer had an arguable basis to deny the claim, the insured's bad faith claim will fail as a matter of law regardless of how the insurer conducted the investigation. *LeRette v. American Medical Sec., Inc.*, 705 N.W.2d 41, 43 (Neb. 2005).

- What are the recoverable damages for the bad faith cause of action?

  - Attorney fees are recoverable. *See* Neb. Rev. Stat. § 44-359.

  - Consequential damages, including emotional distress, are recoverable in specific circumstances. *See Ruwe v. Farmers Mut. United Ins. Co. Inc.*, 469 N.W.2d 129 (Neb. 1991); *Braesch v. Union Ins. Co.*, 464 N.W.2d 769 (Neb. 1991) [*disapproved on other grounds*].

- Are punitive damages recoverable?

    - No. *See Abel v. Conover*, 104 N.W.2d 684 (Neb. 1960); *Braesch v. Union Ins. Co.*, 464 N.W.2d 769, 777 (Neb. 1991) [*disapproved on other grounds*] ("punitive damages are not allowed in Nebraska").

- Are punitive damages insurable?

    - No. Nebraska has not recognized such a cause of action.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - No. Nebraska has not recognized such a cause of action.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No such cause of action has been recognized.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - There are no statutory grounds for a third party action for bad faith.

    - Insurance companies are regulated by the Unfair Insurance Trade Practices Act, Neb. Rev. Stat. § 44-1501 et. seq.

    - Unfair Claims Handling is regulated by Neb. Rev. Stat. § 44-1525(9).

    - Unfair Claims Settlement Practices is regulated by Neb. Rev. Stat. § 44-1540.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - In general, the covenant of good faith and fair dealing is dependent upon a contractual relationship between the plaintiff and the insurer. *Braesch v. Union Ins. Co.*, 464 N.W.2d 769, 772, 776 (Neb. 1991) [*disapproved on other grounds*].

    - However, an injured policyholder who is also a "covered person", or a policy beneficiary who is also a policy holder may bring a bad faith claim against the insurer. *Braesch v. Union Ins. Co.*, 464 N.W.2d 769, 772, 776 (Neb. 1991) [*disapproved on other grounds*] ("This state recognizes a cause of action for an insurer's bad faith in refusing to settle a claim with a third party." "(1) [A]n injured policyholder who is also a "covered person" or (2) a policyholder who is also a beneficiary may bring a cause of action in tort against the policyholder's insurer for failure to settle the policyholder's insurance claim."). In this case, policyholders were parents of a girl killed by an uninsured driver. The insurer allegedly failed to settle the uninsured motorist claim in good faith. The parents, as policyholder beneficiaries, had standing to sue. See also *Olson v. Union Fire Ins. Co.*, 118 N.W.2d 318 (Neb. 1962).

    - To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the [insurance] policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. It is apparent, then, that the tort of bad faith is an intentional one. "Bad faith" by definition cannot be unintentional. *Braesch v. Union Ins. Co.*, 464 N.W.2d 769, 772, 777 [*disapproved on other grounds*].

- What are the recoverable damages for the bad faith cause of action?

    - Tort damages, including emotional distress, are recoverable in specific circumstances. *Braesch v. Union Ins. Co.*, 464 N.W.2d 769 (Neb. 1991) [*disapproved on other grounds*].

NEVADA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No, but with some exceptions.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. The Nevada Legislature has enacted the Unfair Claims Settlement Practices Act ("UCSPA"), codified at Nev. Rev. Stat. Ann. § 686A.310.

      UNFAIR CLAIMS SETTLEMENT PRACTICES ACT

      NRS 686A.310. Unfair practices in settling claims; liability of insurer for damages.

      1. Engaging in any of the following activities is considered to be an unfair practice:

      (a) Misrepresenting to insureds or claimants pertinent facts or insurance policy provisions relating to any coverage at issue.

      (b) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

      (c) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

      (d) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.

(e) Failing to effectuate prompt, fair and equitable settlements of claims in which liability of the insurer has become reasonably clear.

(f) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when the insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

(g) Attempting to settle a claim by an insured for less than the amount to which a reasonable person would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.

(h) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured, his representative, agent or broker.

(i) Failing, upon payment of a claim, to inform insureds or beneficiaries of the coverage under which payment is made.

(j) Making known to insureds or claimants a practice of the insurer of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration.

(k) Delaying the investigation or payment of claims by requiring an insured or a claimant, or the physician of either, to submit a preliminary claim report, and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information.

(l) Failing to settle claims promptly, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

(m) Failing to comply with the provisions of NRS 687B.310 to

687B.390, inclusive, or 687B.410.

(n) Failing to provide promptly to an insured a reasonable explanation of the basis in the insurance policy, with respect to the facts of the insured's claim and the applicable law, for the denial of his claim or for an offer to settle or compromise his claim.

(o) Advising an insured or claimant not to seek legal counsel.

(p) Misleading an insured or claimant concerning any applicable statute of limitations.

2. In addition to any rights or remedies available to the commissioner, an insurer is liable to its insured for any damages sustained by the insured as a result of the commission of any act set forth in subsection 1 as an unfair practice.

- The UCSPA is broader in scope than common law bad faith, but more limited in application. "The statute proscribes specific actions taken by an insurer which Nevada has deemed to be unfair whether or not they are related to a denial of insurance benefits." *Hart v. Prudential Property & Cas. Ins. Co.*, 848 F. Supp. 900, 904 (D. Nev. 1994). However, the UCSPA only applies to insurance companies, not insurance agents or brokers. *Albert H. Wohlers & Co. v. Bartgis*, 114 Nev. 1249, 1263, 969 P.2d 949, 959 (1998).

- The UCSPA creates a private cause of action for damages incurred as a result of the statutory violation, but a violation *does not* automatically constitute common law bad faith. *Hart v. Prudential Property & Cas. Ins. Co.*, 848 F. Supp. 900, 904 (D. Nev. 1994). For example, an insurer may violate the UCSPA by failing to investigate a claim before denying it. The failure to investigate may give rise to appropriate damages under the UCSPA, "where under the common law, a failure to investigate merely impacts the reasonableness of the denial." *Id.* at 904 n.4. "[B]ad faith does not directly address the manner in which an insurer processes a claim as does NRS 686A.310. Bad faith exists where an insurer denies a claim without any reasonable basis and with knowledge that no reasonable basis exists to deny the claim. In contrast, the provisions of NRS 686A.310 address the manner in which an

insurer handles an insured's claim whether or not the claim is denied." *Schumacher v. State Farm Fire & Cas. Co.*, 467 F. Supp. 2d 1090, 1095 (D. Nev. 2006) (internal citations omitted).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. The Supreme Court of Nevada adopted the cause of action called "bad faith" in *United States Fidelity & Guar. Co. v. Peterson*, 91 Nev. 617, 540 P.2d 1070 (1975).

    - **Traditional Common Law Bad Faith**

        - "Nevada's definition of bad faith is: (1) an insurer's denial of (or refusal to pay) an insured's claim; (2) without any reasonable basis; and (3) the insurer's knowledge or awareness of the lack of any reasonable basis to deny coverage, or the insurer's reckless disregard as to the unreasonableness of the denial." *Schumacher v. State Farm Fire & Casualty Co.*, 467 F. Supp. 2d 1090, 1095 (D. Nev. 2006). Or in other words, "Bad faith is established where the insurer acts unreasonably and with knowledge that there is no reasonable basis for its conduct." *Guaranty Nat'l Ins. Co. v. Potter*, 112 Nev. 199, 206, 912 P.2d 267, 272 (1996).

    - **Breach of the Implied Covenant of Good Faith and Fair Dealing**

        - Nevada law recognizes an implied covenant of good faith and fair dealing in every contract. *Lopez v. American Family Mutual Ins. Co.*, 2009 U.S. Dist. LEXIS 59726 (D. Nev. 2009). However, an action in tort (as opposed to an action in contract) for breach of this implied covenant arises only in rare and exceptional cases when there is a special relationship between the victim and tortfeasor. The relationship of insurer and insured is one such special relationship. *Insurance Co. of the West v. Gibson Tile Co.*, 122 Nev. 455, 462, 134 P.3d 698, 702 (2006). "The law, not the insurance contract, imposes this covenant on insurers. A violation of the covenant gives rise to a bad-faith tort claim."

Allstate Ins. Co. v. Miller, 125 Nev. Adv. Rep. 28, 212 P.3d 318, 324 (2009) (internal citation omitted).

- "The insurer-insured relationship is fiduciary in nature, and a jury's finding of a breach of fiduciary duty may support the finding of bad faith. Misrepresenting or concealing facts to gain an advantage over the insured constitutes a breach of fiduciary responsibility." *Id.* at 122 Nev. 463. See also *Powers v. United Servs. Auto. Ass'n*, 114 Nev. 690, 701-702, 962 P.2d 596, 602 (1998) ("We are not adopting a new cause of action based on an insurance company's failure to put its insured's interests above its own; we are merely recognizing that breach of the fiduciary nature of the insurer-insured relationship is part of the duty of good faith and fair dealing.")

- Thus, the tort of insurance bad faith is largely, if not entirely, synonymous with the tortious breach of the implied covenant of good faith and fair dealing in the context of the insurer-insured relationship. "'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.'" *Brandau v. Am. Family Mut. Ins. Co.*, 2006 U.S. Dist. LEXIS 40279 (D. Nev. 2006), quoting *Pemberton v. Farmers Ins. Exch.*, 109 Nev. 789, 858 P.2d 380, 382 (1993). "Such conduct is a breach of the covenant of good faith and fair dealing, and constitutes bad faith." *Brandau*, 2006 U.S. Dist. LEXIS 40279.

- **Failure to Settle**

- Bad faith also arises in the context of failure by a liability insurer to settle a claim against the insured within the policy limits. *Allstate Ins. Co. v. Miller*, 125 Nev. Adv. Rep. 28, 212 P.3d 318, 328 (2009). A liability insurer "has a contractual right to have an underlying judgment determined by trial or settlement, and it is not required under the implied covenant of good faith and fair dealing to accept an excessive stipulated settlement offer between the insured and the claimant." *Id.*, 212 P.3d at 331. Furthermore, a liability insurer "is not required to take on monetary obligations

outside its insurance contract, which includes agreeing to an excessive settlement offer." *Id.*

- A bad faith claim for failure to settle requires the showing that the insurer acted in deliberate refusal to discharge its contractual duties. Thus if the insurer's actions resulted from an honest mistake, bad judgment, or negligence, then the insurer is not liable under a bad faith theory. *Allstate Ins. Co. v. Miller*, 125 Nev. Adv. Rep. 28, 212 P.3d 318, 330 (2009).

- An insurer can be liable for bad faith failure to settle even where a demand exceeds policy limits if the insured is willing and able to pay the amount of the proposed settlement that exceeds policy coverage. *Allstate Ins. Co. v. Miller*, 125 Nev. Adv. Rep. 28, 212 P.3d 318, 329 (2009).

- **Duty to Inform**

  - Failure to adequately inform an insured of a settlement offer also constitutes a violation of the implied covenant of good faith and fair dealing and is grounds for a bad faith claim. *Allstate Ins. Co. v. Miller*, 125 Nev. Adv. Rep. 28, 212 P.3d 318, 326 (2009).

- **Application of Common Law Bad Faith**

  - Note that while the UCSPA applies only to insurers, common law bad faith may apply to tortfeasors other than insurance companies. "In general, no one "is liable upon a contract except those who are parties to it. However, according to a well-established exception to this general rule, where a claims administrator is engaged in a joint venture with an insurer, the administrator 'may be held liable for its bad faith in handling the insured's claim, even though the organization is not technically a party to the insurance policy.'" *Albert H. Wohlers & Co. v. Bartgis*, 114 Nev. 1249, 1262-1263, 969 P.2d 949, 959 (1998), quoting William M. Shernoff et al., Insurance Bad Faith Litigation § 2.03[1], at 2-10 (1998) (other internal citation omitted). In *Bartgis*, the Supreme Court of Nevada held that an insurance

administrator could also be held liable for common law bad faith under a joint venture theory, where the administrator "developed promotional material, issued policies, billed and collected premiums, paid and adjudicated claims, and assisted [the insurer] in the development of the ancillary charges limitation provision." *Id.*

- **When does Common Law Bad Faith Become Actionable?**

  - The focus of common law bad faith under Nevada law is the unreasonable *denial* of benefits of an insurance policy. *Day Construction Co., Inc. v. Clarendon America Ins. Co.*, 459 F. Supp. 2d 1039, 1052 (D. Nev. 2006).

- What is the applicable statute of limitations?

  - The insurer's duty to deal in good faith is an obligation imposed by law, it does not arise from the terms of the insurance contract; thus, a bad faith tort claim must be commenced within the **four-year statute of limitations** applicable to actions upon a liability not founded upon an instrument in writing. *Schumacher v. State Farm Fire & Casualty Co.*, 467 F. Supp. 2d 1090, 1094-95 (D. Nev. 2006). See also NRS 11.190(2)(c).

  - Claims brought under the Unfair Claims Settlement Practices Act must be brought within **three years**, as such claims constitute an action upon liability created by statute. *Schumacher v. State Farm Fire & Casualty Co.*, 467 F. Supp. 2d 1090, 1095 (D. Nev. 2006). See also NRS 11.190.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - An insurance company is not liable for bad faith if it had a reasonable basis for denying a claim. *Lopez v. American Family Mutual Ins. Co.*, 2009 U.S. Dist. LEXIS 59726 (D. Nev. 2009). This issue generally presents an issue of fact. *Id.*

  - Where an insurer's refusal to pay insurance benefits is based on a reasonable interpretation of the insurance contact, there is no basis

for concluding that the insurer acted in bad faith. *Hummel v. Continental Casualty Ins. Co.*, 254 F. Supp. 2d 1183, 1191 (D. Nev. 2003).

- Duty to Settle Defense: A bad faith claim for failure to settle requires the showing that the insurer acted in deliberate refusal to discharge its contractual duties. Thus if the insurer's actions resulted from an honest mistake, bad judgment, or negligence, then the insurer is not liable under a bad-faith theory. *Allstate Ins. Co. v. Miller*, 125 Nev. Adv. Rep. 28, 212 P.3d 318, 330 (2009).

- There is no duty to defend where there is no potential for coverage. *United National Ins. Co. v. Frontier Ins. Co.*, 120 Nev. 678, 687, 99 P.3d 1153 (2004). The duty to defend is broader in scope than the duty to indemnify. *Id.* Thus, it logically follows that there is no duty to settle a non-covered claim.

- What are the recoverable damages for the bad faith cause of action?

  - **UNFAIR CLAIMS SETTLEMENT PRACTICES ACT**

    - *In addition to any rights or remedies available to the commissioner, an insurer is liable to its insured for any damages sustained by the insured as a result of the commission of any act set forth in subsection 1 as an unfair practice.* NRS 686A.310(2).

  - **COMMON LAW**

    - In addition to compensatory damages, damages for emotional distress may be awarded. "Nevada law also recognizes that the tort of insurance bad faith goes beyond a mere economic offense because it deprives the insured of the bargained for consideration, peace of mind." *Merrick v. Paul Revere Life Ins. Co.*, 594 F. Supp 2d 1168, 1186 (D. Nev. 2008) (court awarded Plaintiff damages for emotional distress.)

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

- NRS 42.005 provides that punitive damages may be awarded "in an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been **guilty of oppression, fraud or malice, express or implied**." See also *Guaranty Nat'l Ins. Co. v. Potter*, 112 Nev. 199, 208, 912 P.2d 267, 273 (1996).

  "Oppression" has been defined as "a conscious disregard for the rights of others which constitutes an act of subjecting plaintiffs to cruel and unjust hardship." *Guaranty Nat'l Ins. Co. v. Potter*, 112 Nev. 199, 208, 912 P.2d 267, 273 (1996).

  "Malice" is conduct which is intended to injure a person or despicable conduct which is engaged in with a conscious disregard of the rights and safety of others. *Fries v. State Farm Mutual Auto Ins. Co.*, 2010 U.S. Dist. LEXIS 14963 (D. Nev. 2010).

- NRS 42.005 provides for statutory caps on punitive damage awards in all but certain classes of cases. However, it specifically does *not* cap punitive damages in insurance bad faith cases.

  NRS 42.005 - Exemplary and punitive damages: In general; limitations on amount of award; determination in subsequent proceeding.

  1. Except as otherwise provided in NRS 42.007, in an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud or malice, express or implied, the plaintiff, in addition to the compensatory damages, may recover damages for the sake of example and by way of punishing the defendant. Except as otherwise provided in this section or by specific statute, an award of exemplary or punitive damages made pursuant to this section may not exceed:

  (a) Three times the amount of compensatory damages awarded to the plaintiff if the amount of compensatory damages is $100,000 or more; or

  (b) Three hundred thousand dollars if the amount of compensatory damages awarded to the plaintiff is less than $100,000.

2. The limitations on the amount of an award of exemplary or punitive damages prescribed in subsection 1 do not apply to an action brought against:

(a) A manufacturer, distributor or seller of a defective product;

(b) An insurer who acts in bad faith regarding its obligations to provide insurance coverage;

(c) A person for violating a state or federal law prohibiting discriminatory housing practices, if the law provides for a remedy of exemplary or punitive damages in excess of the limitations prescribed in subsection 1;

(d) A person for damages or an injury caused by the emission, disposal or spilling of a toxic, radioactive or hazardous material or waste; or

(e) A person for defamation.

3. If punitive damages are claimed pursuant to this section, the trier of fact shall make a finding of whether such damages will be assessed. If such damages are to be assessed, a subsequent proceeding must be conducted before the same trier of fact to determine the amount of such damages to be assessed. The trier of fact shall make a finding of the amount to be assessed according to the provisions of this section. The findings required by this section, if made by a jury, must be made by special verdict along with any other required findings. The jury must not be instructed, or otherwise advised, of the limitations on the amount of an award of punitive damages prescribed in subsection 1.

4. Evidence of the financial condition of the defendant is not admissible for the purpose of determining the amount of punitive damages to be assessed until the commencement of the subsequent proceeding to determine the amount of exemplary or punitive damages to be assessed.

5. For the purposes of an action brought against an insurer who acts in bad faith regarding its obligations to provide insurance coverage, the definitions set forth in NRS 42.001 are not applicable and the corresponding provisions of the common law apply.

- A court will not disturb an award of punitive damages unless "the record lacks substantial evidence to support the required finding of 'oppression, fraud or malice, express or implied.'" *Guaranty Nat'l Ins. Co. v. Potter*, 112 Nev. 199, 208, 912 P.2d 267, 273 (1996).

- Are punitive damages insurable?

  - In 1995, the Legislature enacted Nev.Rev.Stat. 681A.095, which permitted insurance protection under certain specified conditions: "*An insurer may insure against legal liability for exemplary or punitive damages that do not arise from a wrongful act of the insured committed with the intent to cause injury to another.*" Whether an insurance contract will be judicially construed to cover punitive damages is thus a question of contract interpretation. Policy interpretation will be conducted according to standard principles: "An insurance policy is to be judged from the perspective of one not trained in the law or in insurance, with the terms of the contract viewed in their plain, ordinary, and popular sense." *Siggelkow v. Phoenix*, 846 P.2d at 306, citing *National Union Fire Insurance Co. v. Reno's Executive Air, Inc.*, 100 Nev. 360, 682 P.2d 1380 (1984).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - Presently there is no Nevada statute or reported case recognizing that an insurer is responsible for punitive damages assessed against the insured when those damages are imposed against the insured following an insurer's failure to settle. It is an open question whether such punitive damages may be recovered in such circumstances as an item of consequential damages flowing from the insurer's breach of duty.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - Presently there is no Nevada statute or reported case requiring the appointment of "Cumis" counsel.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Presently there is no Nevada statute or reported case recognizing that an insurer may be liable for the malpractice of its appointed defense counsel.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - The Supreme Court of Nevada has held that a third-party claimant does not have a private right of action under NRS 686A.310. *Gunny v. Allstate Ins. Co.*, 108 Nev. 344, 346, 830 P.2d 1335 (1992). However, the United States District Court for the District of Nevada has suggested that a person defined as an "insured" under a policy, but who is not the actual contracting party, may be able to sue under NRS 686A.310. "Nevada does not exclude non-contracting parties from asserting a private right of action for violation of the Unfair Claims Act. Instead, only third-party claimants and parties without a contractual relationship with an insurer cannot assert a claim under the Unfair Claims Act." *Bergerud v. Progressive Cas. Ins.*, 453 F. Supp. 2d 1241, 1250 (D. Nev. 2006).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Nevada has not extended to third parties the right to sue an insured's liability insurer for failure to settle the third party's claim against the insured. *Tweet v. Webster*, 614 F. Supp. 1190, 1195 (D. Nev. 1985). However, the United States District Court for the District of Nevada has suggested that a claimant seeking to recover his own benefits under a policy, and who is defined as an "insured" under the policy, may be able to sue for bad faith denial of those benefits even if he is not the actual contracting party. See *Bergerud v. Progressive Casualty Ins.*, 453 F. Supp. 2d 1241, 1249-50

(D. Nev. 2006). Furthermore, non-contracting "insureds" are permitted to sue for bad faith denial of uninsured / underinsured motorist benefits. "[T]he Nevada Supreme Court's decision in *Pemberton* extended the duty of good faith to insureds claiming UM benefits without differentiating between contracting insureds and policy-defined insureds, such as third-party beneficiaries. Nevada's public policy, embodied in the Insurance Code, also does not differentiate between the two. Instead, it requires insurers to provide UM benefits to all parties the insurance policy defines as 'insured.'" *Id.* at 1250, citing *Pemberton v. Farmers Ins. Exch.,* 109 Nev. 789, 858 P.2d 380 (1993).

NEW HAMPSHIRE

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes, an insured can sue for breach of contract, but not in tort.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - A private party may bring a cause of action against the insurer for a violation of RSA 417 (Unfair Insurance Trade Practices) after the Insurance Commissioner had found a practice to have violated the chapter. *See* RSA 417:19.

    - Unfair Claim Settlement Practices by insurers is regulated by RSA 417:4 (XV).

    - RSA 358-A provides for the Regulation of Business Practices for Consumer Protection. However, insurance practice is exempt from this act. *Bell v. Liberty Mutual Ins. Co.*, 146 N.H. 190, 194, 776 A.2d 1260 (2001).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Under New Hampshire law, there is a common law cause of action sounding in contract. *Lawton v. Great Southwest Fire Ins. Co.*, 392 A.2d 576 (N.H. 1978). "There is . . . implied in every contract an obligation of good faith and fair dealing." *Id.* at 612.

    - There is no recognized tort of bad faith cause of action for an insurer's refusal or delay to settle a first party insurance claim. *See*

Lawton, 392 A.2d at 581; *Jarvis v. Prudential Ins. Co. of America*, 122 N.H. 648, 448 A.2d 407 (1982).

- An insured can sue in negligence for failure to settle a third party claim. *See Dumas v. Hartford Accident & Indem. Co.*, 94 N.H. 484, 56 A.2d 57 (1947); *Dumas v. State Farm Mutual Auto. Ins. Co.*, 111 N.H. 43, 274 A.2d 781 (1971). *See also Gelinas v. Metropolitan Prop. & Liab. Ins. Co.*, 131 N.H. 154, 551 A.2d 962 (1988). The standard is the care a reasonable man would exercise in the management of his own affairs. Due care must be exercised in ascertaining all the facts of the case both as to liability and damages, in learning the law and in appraising the danger to the insured of being obliged to pay the excess portion of a verdict. The determination must not be done in hindsight, but in a "slow motion rerun of [the insurer's] actions leading up to the verdict." 111 N.H. at 48.

- What are the applicable statutes of limitations?

  - 3 years for claims based on tort and contract. RSA 508:4.

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Evidence regarding the reasonableness of the conduct of the insured or third party claimant is admissible. *See Gelinas v. Metro. Prop. & Liab. Ins. Co.*, 551 A.2d 962, 967 (N.H. 1998).

  - Professional advice is "merely one item to be considered in determining the due care of the indemnity company." *Dumas v. Hartford Accident & Indem. Co.*, 56 A.2d 57, 61–62 (N.H. 1947).

- What are the recoverable damages for the bad faith cause of action?

  - Attorney fees are recoverable.

    - An insured can recover attorneys' fees if successful in obtaining declaratory relief in an insurance coverage dispute. RSA 491:22.

        - Attorneys' fees are recoverable "[w]henever a consumer shall prevail in an action brought under RSA 417:19 (I)." RSA 417:20 (III).

        - If an insurer acts in bad faith by advancing unnecessary litigation, attorneys' fees can be awarded. *Lawton v. Great Southwest Fire Ins. Co.*, 392 A.2d 576 (N.H. 1978) (citing *Harkeem v. Adams*, 377 A.2d 617 (N.H. 1977)).

    - Actual damages and those that "the defendant had reason to foresee as a probable result of its breach when the contract was made" are recoverable. *Lawton*, 392 A.2d at 611 (citing *Emery v. Caledonia Sand & Gravel Co.*, 374 A.2d 929, 932 (N.H. 1977)).

    - Damages for mental distress are not recoverable. *Jarvis v. Prudential Ins. Co. of America*, 122 N.H. 648, 654, 448 A.2d 407 (1982); *Bell v. Liberty Mut. Ins. Co.*, 146 N.H. 190, 194, 776 A.2d 1260 (N.H. 2001).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Not *per se*. However, an insurer can be assessed an administrative penalty "for each method of competition, act or practice to be in violation of this chapter pursuant to RSA 417:12." RSA 417:13.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - There are no statutory grounds for a third party action for bad faith. *See Bell v. Liberty Mut. Ins. Co.*, 146 N.H. 190, 194, 776 A.2d 1260 (N.H. 2001).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No.

NEW JERSEY

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - The two statues governing unfair claim settlement practices are N.J.S.A. § 17:29B-4(9) and N.J.S.A. §17B:30-13.1.

        - N.J.S.A. § 17:29B-4(9) provides:

        Unfair claim settlement practices. Committing or performing with such frequency as to indicate a general business practice any of the following:

        (a) Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;

        (b) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;

        (c) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;

        (d) Refusing to pay claims without conducting a reasonable investigation based upon all available information;

        (e) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;

(f) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;

(g) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;

(h) Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;

(i) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured;

(j) Making claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which the payments are being made;

(k) Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;

(l) Delaying the investigation or payment of claims by requiring an insured, claimant or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;

(m) Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage;

(n) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement;

(o) Requiring insureds or claimants to institute or prosecute complaints regarding motor vehicle violations in the municipal court as a condition of paying private passenger automobile insurance claims.

- N.J.S.A. §17B:30-13.1 provides:

No person shall engage in unfair claim settlement practices in this State. Unfair claim settlement practices which shall be unfair practices as defined in N.J.S. 17B:30-2, shall include the following practices:

Committing or performing with such frequency as to indicate a general business practice any of the following:

a. Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;

b. Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;

c. Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;

d. Refusing to pay claims without conducting a reasonable investigation based upon all available information;

e. Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;

f. Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;

g. Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;

h. Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;

i. Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured;

j. Making claims payments to insureds or beneficiaries not accompanied by statement setting forth the coverage under which the payments are being made;

k. Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;

l. Delaying the investigation or payment of claims by requiring an insured, claimant or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;

m. Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage;

n. Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - New Jersey recognizes a cause of action for first-party bad faith, which sounds in contract. *Pickett v. Lloyd's*, 621 A.2d 445, 450 (N.J. 1993).

    - **Standard**: "Fairly debatable" standard -- To establish a bad-faith claim, the insured "must show the absence of a reasonable basis for denying benefits of the policy and the [insurer's] knowledge or reckless disregard of the lack of a reasonable basis for denying the claim." *Pickett*, 621 A.2d at 453.

    - **Major cases**: *Pickett v. Lloyd's*, 621 A.2d 445 (N.J. 1993). *See also Ward v. Merrimack Mut. Fire Ins. Co.*, 753 A.2d 1214 (N.J. Super. Ct. App. Div. 2000).

- What are the applicable statutes of limitations?

    - 6 years. See N.J.S.A. 2A.14-1.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Court "must rule, as a matter of law, as to an insured's bad faith claim, if it finds genuine issues of material fact precluding summary judgment as to the underlying claim." *Tarsio v. Provident Ins. Co.*, 108 F. Supp. 2d 397, 401 (D.N.J. 2000). However, if the court finds that the insured would be entitled to summary judgment, the bad faith claim "does not necessarily prevail, . . . [and] the court must engage in further analysis." *Tarsio*, 108 F. Supp. 2d at 401, n.5.

- What are the recoverable damages for the bad faith cause of action?

- Breach of contract, amounts policy holder paid to resolve the claim in excess of policy. *Pickett v. Lloyd's*, 621 A.2d 445.

- N.J. Court Rule 4:42-9 --Allows for the award of counsel fees.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Absent egregious circumstances, no right to recover for emotional distress or punitive damages exists for an insurer's allegedly wrongful refusal to pay a first-party claim. *Pickett v. Lloyd's*, 621 A.2d 445.

- Are punitive damages insurable?

  - Directly assessed punitive damages are not insurable. *See Johnson & Johnson v. Aetna Cas. and Sur. Co.*, 667 A.2d 1087 (N.J. Super. A.D. 1995) (holding insurance coverage of punitive damages is against public policy); *see also, Variety Farms, Inc. v. New Jersey Manufacturers Ins. Co.*, 410 A.2d 696 (N.J. Super. A.D. 1980); *LoRocco v. New Jersey Manufacturers Indem. Ins. Co.*, 197 A.2d 591 (N.J. Super. A.D. 1964), *cert. denied*, 199 A.2d 655 (N.J. 1964).

  - Vicariously assessed punitive damages, however, may be insurable. See *Malanga v. Manufacturers Cas. Ins. Co.*, 146 A.2d 105 (N.J. 1958) (granting insurance coverage on behalf of a vicariously liable partnership). However, in *dicta*, the court in *Johnson & Johnson, supra,* interpreted *Malanga's* holding as applying principles of partnership law, and stated that public policy bars coverage even if the insured was held vicariously liable.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - Unsettled. Once an insured proves bad faith on the part of the insurer, a prima facie case is established for damages equaling the difference between the policy limits and the excess verdict. *Yeomans v. Allstate Ins. Co.*, 130 N.J.Super. 48 (App.Div. 1974). The

excess verdict could clearly include punitive damages; however, the law in New Jersey provides that "public policy does not permit a tortfeasor to shift the burden of punitive damages to his insurer." *Variety Farms, Inc. v. New Jersey Mfrs. Ins. Co.,* 172 *N.J.Super.* 10, 25, 410 *A.*2d 696 (App.Div.1980).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - New Jersey addressed the issue of selection of independent counsel in *Burd v. Sussex Mut. Ins. Co.*, 267 A.2d 7 (N.J. 1970). In New Jersey, the insured is allowed to select its own defense counsel, with a right of reimbursement from the carrier, if it is later found in the underlying lawsuit that the claim falls within the coverage provided under the policy. *See id.*; *see also Trustees of Princeton Univ. v. Aetna Cas. & Sur. Co.*, 680 A.2d 783 (N.J. Super. 1996); *Voorhees v. Preferred Mut. Ins. Co.*, 246 N.J.Super. 564, 588 A.2d 417 (N.J.Super.A.D. 1991).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No case has decided this issue.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Third parties cannot sue for bad faith.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Third parties cannot sue for bad faith.

NEW MEXICO

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes. *State Farm Gen. Ins. Co. v. Clifton*, 527 P.2d 798 (NM 1974); *Sloan v. State Farm Mut. Auto. Ins. Co*., 135 N.M. 106, 85 P.3d 230 (NM 2004).

- Can third parties sue for bad faith (i.e., third party bad faith)? Yes, in automobile and workers' compensation cases. *Hovet v. Lujan*, 66 P.3d 980, cert. granted 66 P.3d 962 (NM App. 2003), aff'd sub nom *Hovet v. Allstate Ins. Co.*, 135 N.M. 397, 89 P.3d 69 (NM 2004) ("*Hovet*").

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. NMSA §59A-16-20, et seq. *See, Hovet v. Allstate Ins. Co.*, 135 N.M. 397, 89 P.3d 69 (NM 2004). New Mexico's unfair claims practices act was modeled after the NAIC Model Act, but includes a section granting a private right of action.

      Any person covered by Chapter 59A, Article 16 NMSA 1978 who has suffered damages as a result of a violation of that article by an insurer or agent is granted a right to bring an action in district court to recover actual damages. Costs shall be allowed to the prevailing party unless the court otherwise directs. The court may award attorneys' fees to the prevailing party if:

      A. the party complaining of the violation of that article has brought an action that he knew to be groundless; or

      B. the party charged with the violation of that article has willfully engaged in the violation.

      The relief provided in this section is in addition to remedies otherwise available against the same conduct under the common law or other statutes of this state; provided, however, that the Workers'

Compensation Act and the New Mexico Occupational Disease Disablement Law provide exclusive remedies.

Section 59A-16-30 of the Trade Practices and Fraud Article (Article 16) of the Insurance Code.

- "[T]he third-party claimant will not even have an action under Section 59A–16–20(E), unless and until there has been a judicial determination of the insured's fault and the amount of damages awarded in the underlying negligence action. This precludes any claims under Section 59A–16–20(E) if the parties settle." *Hovet v. Allstate Ins. Co.* (2004) 135 N.M. 397, 404-05, 89 P.3d 69 (NM 2004).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Yes. *State Farm Gen. Ins. Co. v. Clifton,* 527 P.2d 798 (NM 1974). Bad faith means any frivolous or unfounded failure to pay a claim covered by the policy. Frivolous means arbitrary or baseless. Unfounded means a reckless disregard, in which the insurance company utterly fails to exercise care for the interests of the insured in denying or delaying payment of the claim. See also *Sloan v. State Farm Mut. Auto. Ins. Co*., 135 N.M. 106, 85 P.3d 230 (NM 2004).

  - In failure to pay cases, a showing that the insurer acted unreasonably in denying or delaying a claim can entitle the plaintiff to compensatory damages. *Sloan v. State Farm Mut. Auto. Ins. Co*., 135 N.M. 106, 85 P.3d 230 (NM 2004).

    - See also *Yumukoglu v. Provident Life & Accident Ins. Co*., 36 Fed.Appx. 378, 381 (10th Cir. 2002), a disability insurance case, in which the court said that to prove bad faith an insured must demonstrate the refusal to pay rested upon an entirely "frivolous" basis, which requires evidence that the insurer's decision featured "[a]n utter or total lack of foundation" and "[constituted] an arbitrary or baseless refusal to pay, lacking any arguable support in the wording

of the insurance policy or the circumstances surrounding the claim."

- While New Mexico recognizes a cause of action for bad faith failure to settle, it does not recognize the claim of negligent failure to settle. *Sloan v. State Farm Mut. Auto Ins. Co.*, 135 N.M. 106, 113, 85 P.2d 230, 237 (2004); *Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 102 N.M. 28, 690 P.2d 1022 (1984).

  - Bad faith conduct typically involves a culpable mental state. *Sloan*, 135 N.M. at 109-10.

  - "To be entitled to recover for bad-faith failure to settle, a plaintiff must show that the insurer's refusal to settle was based on a dishonest judgment. By 'dishonest judgment,' we mean that an insurer has failed to honestly and fairly balance its own interests and the interests of the insured. An insurer cannot be partial to its own interests, but rather must give the interests of its insured at least the same consideration or greater." *Sloan*, 135 N.M. at 113; see *Hovet v. Lujan*, 133 N.M. 661 (2003).

  - In failure to settle cases, evidence of negligence can be used to show bad faith, but does not give rise to its own cause of action. *Sloan*, 135 N.M. at 113.

- What are the applicable statutes of limitations?

  - 6 years for a written contract. NMSA §37-1-3.

  - 4 years for an action based on the unfair claims practices act. NMSA §37-1-4. *Martinez v. Cornejo*, 146 N.M. 223, 208 P.3d 443, 452 (2008).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - An insurer has not committed bad faith where it has made a full, diligent and complete investigation and honestly balanced the interests of the insured with its own, giving equal weight to the

interests of the insured. *Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 690 P.2d 1022, 1026 (NM 1984); see NMSA §9A-16-20/30.

- What are the recoverable damages for the bad faith cause of action?

    - General and special damages and attorneys fees. If there is a violation of the Unfair Claims Practices Act damages may be trebled. NMSA§57-12-10(B). The Superintendent of Insurance may impose penalties under NMSA §59A-1-18.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes. In claims for benefits due to the insured under the policy, the insured must prove the insurance company failed to pay for reasons that were frivolous and unfounded. *Sloan v. State Farm Mut. Auto. Ins. Co*., 135 N.M. 106, 85 P.3d 230 (NM 2004)*; State Farm Gen. Ins. Co. v. Clifton*, 527 P.2d 798 (NM 1974).

    - In claims for failure to settle a liability claim pending against the insured, the insured must prove that the insurance company's failure to settle was based upon a dishonest and unfair balancing of interests. *Sloan v. State Farm Mut. Auto. Ins. Co*., 135 N.M. 106, 85 P.3d 230 (NM 2004). "It is the insurer's failure to treat the insured honestly and in good faith, giving equal consideration to its own interests and the interests of the insured, that renders the insurer liable for insurance bad faith and also merits an instruction on punitive damages." *Id*. at 114. See also *Dairyland Ins. Co. v. Herman*, 124 N.M. 624, 633 (1997).

    - *Jackson Nat. Life Ins. Co. v. Receconi*, 113 N.M. 403, 419, 827 P.2d 118, 134 (1992). The assessment of punitive damages for breach of an insurance policy requires evidence of bad faith or malice in the insurer's refusal to pay a claim. "Bad faith" has been defined as "any frivolous or *unfounded* refusal to pay." "Unfounded" in this context does not mean "erroneous" or "incorrect"; it means essentially the same thing as "reckless disregard," in which the insurer "*utterly* fail[s] to exercise care for the interests of the insured in denying or delaying payment on an insurance policy." It means an utter or total lack of foundation for an assertion of nonliability—

an arbitrary or baseless refusal to pay, lacking any arguable support in the wording of the insurance policy or the circumstances surrounding the claim. It is synonymous with the word with which it is coupled: "frivolous."

- A punitive damages instruction will ordinarily be given whenever the plaintiff is entitled to an instruction on insurance bad faith. *Sloan*, 135 N.M. at 112.

- Are punitive damages insurable?

  - Yes, punitive damages are insurable. *Baker v. Armstrong*, 106 N.M. 395, 396 (1987). Court should not add an exclusion of liability for punitive damages in an insurance contract where there is nothing in the policy to forewarn insured that such was the parties' intent. *Id.* at 396.

  - For purposes of UIM coverage, New Mexico has characterized punitive damages as deriving from actual damages. *Stewart v. State Farm Mut. Auto. Ins. Co.,* 104 N.M. 744, 746, 726 P.2d 1374, 1376 (1986). Punitive damages are therefore included within an insured's UIM coverage. *Id.* Express exclusions of punitive damages from UIM coverage are void as against public policy. See *Stinbrink v. Farmers Ins. Co.,* 111 N.M. 179, 180–81, 803 P.2d 664, 665–66 (1990). "[P]unitive damages are as much a part of the potential award under the uninsured motorist statute as damages for bodily injury, and therefore they *cannot be contracted away*." Id. at 180, 803 P.2d at 665.

  - The Mandatory Financial Responsibility Act does not require automobile liability coverage for punitive damages and an exclusion of coverage for punitive damages is valid. *State Farm Mut. Auto. Ins. Co. v. Progressive Specialty Ins. Co.,* 131 N.M. 304 (2001).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

- No case has decided this issue. However, as punitive damages can be insurable, it may follow that an excess judgment can include them.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - The New Mexico Supreme Court has held that when a conflict of interest between the insurer and insured arises, it can be handled by insisting the insured hire independent counsel, by the insurer hiring two counsel, one to represent it and one to represent the insured, by a declaratory relief action or by a reservation of rights agreement. *American Emp. Ins. Co. v. Crawford*, 533 P.2d 1203 (N.M. 1975).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No such cause of action has been recognized.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. *Hovet v. Allstate Ins. Co.*, 135 N.M. 397, 404-05, 89 P.3d 69 (NM 2004). Section 59A-16-20 of the Trade Practices and Fraud Article (Article 16) of the Insurance Code prohibits insurance companies from engaging in certain "unfair and deceptive practices," which include "not attempting in good faith to effectuate prompt, fair and equitable settlements of an insured's claims in which liability has become reasonably clear." *Hovet*, 135 NM 399, 89 P.3d at 71. The private right of action created in Section 59A-16-30 of the Trade Practices and Fraud Article (Article 16) of the Insurance Code, quoted above, applies to third party claimants. *Hovet v. Allstate Ins. Co.*, 135 N.M. 397, 404-05, 89 P.3d 69, 76 (NM 2004). However, this case was limited to automobile liability insurance.

        - Note: The claim may only be filed after and conclusion of the claim against the insured and after there has been a judicial determination of fault in favor of the third party. *Hovet v. Allstate Ins. Co.*, 135 N.M. 397, 404, 89 P.3d 69, 76 (NM 2004).

    - *Russell v. Protective Ins. Co.,* 107 N.M. 9, 13–14, 751 P.2d 693, 697–98 (NM 1988) (allowing an injured worker to sue an insurer for bad faith refusal to pay workers' compensation benefits because the worker "was an intended beneficiary of the contract between his employer and the insurer"), *superseded by statute as stated in Meyers v. Western Auto,* 2002–NMCA–089, ¶ 16, 132 N.M. 675, 54 P.3d 79.

    - *Jolley v. Associated Electric & Gas Ins. Services Ltd. (AEGIS)*, 148 N.M. 436, 441, 237 P.3d 738 (NM 2010), refused to extend the holding of *Hovet* to other liability insurance.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - The claim is created by the language of the Unfair Claims Practices Act stating that any person has a private right of action for breach of the statute. NMSA 59A-16-30. This is not an action at common law. *Hovet v. Allstate Ins. Co.,* 135 N.M. 397, 404-05, 89 P.3d 69, 77 (NM 2004).

- What are the applicable statutes of limitations?

    - 4 years for an action based on the unfair claims practices act. NMSA §37-1-4. *Martinez v. Cornejo*, 146 N.M. 223, 208 P.3d 443, 452 (2008).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - "We also emphasize that the Insurance Code does not impose a duty to settle in all instances, nor does it require insurers to settle cases they reasonably believe to be without merit or overvalued. A violation occurs for 'not attempting in good faith to effectuate

prompt, fair and equitable settlements of an insured's claims in which liability has become reasonably clear.' Section 59A-16-20(E). The insurer's duty is founded upon basic principles of fairness. Any insurer that objectively exercises good faith and fairly attempts to settle its cases on a reasonable basis and in a timely manner need not fear liability under the Code." *Hovet v. Allstate Ins. Co.,* 135 N.M. 397, 406, 89 P.3d 69, 79 (NM 2004).

- What are the recoverable damages for the bad faith cause of action?

    - Actual damages and possibly attorneys' fees.

      Any person covered by Chapter 59A, Article 16 NMSA 1978 who has suffered damages as a result of a violation of that article by an insurer or agent is granted a right to bring an action in district court to recover actual damages. Costs shall be allowed to the prevailing party unless the court otherwise directs. The court may award attorneys' fees to the prevailing party if:

      A. the party complaining of the violation of that article has brought an action that he knew to be groundless; or

      B. the party charged with the violation of that article has willfully engaged in the violation.

      The relief provided in this section is in addition to remedies otherwise available against the same conduct under the common law or other statutes of this state; provided, however, that the Workers' Compensation Act and the New Mexico Occupational Disease Disablement Law provide exclusive remedies.

      Section 59A-16-30 of the Trade Practices and Fraud Article (Article 16) of the Insurance Code.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

        - Unsettled. *Hovet v. Allstate Ins. Co.* (2004) 135 N.M. 397, 405, 89 P.3d 69, 77-78 (NM 2004).

NEW YORK

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes

- Can third parties sue for bad faith (i.e., third party bad faith)? Yes

  - New York does not recognize a private cause of action in tort for first party or third party bad faith. However, New York does recognize a contract action for first party and third party bad faith.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

  - No private cause of action exists through statute

  - Unfair Claims Settlement Practices are regulated by N.Y. Ins. Law § 2601.

  - Unfair or deceptive consumer practices are regulated by General Business Law § 349.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - *Bi-Economy Market, Inc. v. Harleysville Ins.*, 856 N.Y.S.2d 505 (N.Y. 2008)

    - Under New York law, there exists a contract duty of good faith and fair dealing, implicit in insurance contracts, which requires a reasonable insurer to investigate a claim in good faith and pay covered claims.

- *Wilner v. Allstate Ins. Co.*, 893 N.Y.S.2d 208 (2d Dept. 2010).

    - At issue in *Wilner*, *supra*, is whether an allegation that the policy is a standard form policy is sufficient to transform the claim into a GBL 349 claim in satisfaction of the requirement that the conduct be directed at the public at large. *Id.* The court held that the plaintiff's claim for punitive damages should not be dismissed. *Id.* at 218.

- What are the applicable statutes of limitations?

    - 6 years for breach of contract claims.

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - An insurer can rely on advice of counsel. Courts have held that to impose punitive damages in this instance would be a harsh result. *See Gordon v. Nationwide Ins. Co.*, 285 N.E. 2d 849 (N.Y. 1972).

    - An affirmative defense can be raised to punitive damages based on the limits of the New York State Constitution and the United States Constitution. *See generally State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003); *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996).

- What are recoverable damages for the bad faith cause of action?

    - In addition to contract damages, New York's highest court has held that consequential damages are available where such damages were foreseeable. *Bi-Economy Market, Inc. v. Harleysville Ins.*, 856 N.Y.S.2d 505, 508 (N.Y. 2008)

        - *See also Globecon Group, LLC v. Hartford Fire Ins. Co.*, 2003 WL 22144316 (S.D.N.Y. Sept. 17, 2003) (citing *Kenford Co. v. County of Erie*, 537 N.E.2d 176 (N.Y. 1989); *Harris v. Provident Life & Accident Ins. Co.*, 310 F.3d 73, 80 (2d Cir. 2002)): Consequential damages are unavailable unless the plaintiff

shows specific injury was considered at the time of contracting.

- Violations of General Business Law § 349 are limited to damages in an amount not to exceed three times the actual damages up to $1,000. NYGBL § 349(h). *See Gaidon v. Guardian Life Ins. Co. of America*, 725 N.E.2d 598 (N.Y. 1999).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Punitive damages are not allowed for mere breach of an insurance contract. Plaintiffs may seek punitive damages if they can demonstrate that they are victims of a tort independent of the insurance contract.

  - Punitive damages are an "extraordinary remedy" and are only available when:

    - there is an independent tort,

    - there is egregious conduct,

    - the egregious conduct was directed at the plaintiff, and

    - the conduct was part of a pattern that was directed at the public generally. *Rocanova v. Equitable Life Assur. Soc.*, 634 N.E.2d 940 (N.Y. 1994).

  - Punitive damages are available only in those limited circumstances where it is necessary to deter the defendant and others like it from engaging in conduct that may be characterized as "gross" and "morally reprehensible" and of such wanton dishonesty as to imply a criminal indifference to civil obligations." *NY University v. Continental Ins. Co.*, 87 N.Y.2d 308 (N.Y. 1995).

  - Punitive damages may also be allowed if the insurer engages in fraud. If an insured files a grievance under § 2601, and that grievance has merit, the insured may be able to use the results of the grievance in pressing a claim for punitive damages. *Belco*

Petroleum Corp v. AIG Oil Rig, Inc., 164 A.D.2d 583 (N.Y.A.D. 1 Dept., 1991).

- Punitive damages may be available against an insurer if there is a showing of morally reprehensible conduct directed at the general public. *Id.* (citing *Walker v. Sheldon*, 10 N.Y.2d 401 (N.Y. 1961)).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - In New York the insured is entitled to defense counsel of its choosing, paid for by the insurer, in cases where a covered claim is alleged along with an uncovered punitive damage claim, and in some cases in which covered and uncovered claims are being defended. *Public Service Mutual Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 401 (1981).

    - "That is not to say that a conflict of interest requiring retention of separate counsel will arise in every case where multiple claims are made. Independent counsel is only necessary in cases where the defense attorney's duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable. When such a conflict is apparent, the insured must be free to choose his own counsel whose reasonable fee is to be paid by the insurer. On the other hand, where multiple claims present no conflict--for example, where the insurance contract provides liability coverage only for personal injuries and the claim against the insured seeks recovery for property damage as well as for personal injuries--no threat of divided loyalty is present and there is no need for the retention of separate counsel. This is so because in such a situation the question of insurance coverage is not intertwined with the question of the insured's liability." *Id.* at 401 fn.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - To be liable for bad faith in a third party matter, the insurer's conduct must constitute a "gross disregard" of the insured's interests. A gross disregard is a deliberate or reckless failure to place the insured's interests on equal footing with the insurer's interests when considering the settlement offer. A bad faith plaintiff must establish that the insurer engaged in a pattern of behavior evincing a conscious or knowing indifference to the possibility that an insured would be held personally accountable for a large judgment if a settlement offer within the policy limits were not accepted. *Pavia v. State farm Mut. Auto. Ins. Co.*, 82 N.Y.2d 445 (N.Y. 1993).

    - Bad faith can be established where liability is clear, and where the potential recovery far exceeds the insurance coverage. *Id.*

    - A number of factors will be considered in determining whether an insurer has acted in bad faith in refusing to settle a claim on behalf of its insured:

        - Whether the insurer informed the insured of the amount of the amount opposing party was prepared to settle.

        - The plaintiff's likelihood of success on the liability issue in the underlying action.

        - The potential magnitude of damages.

        - The financial burden each party may be exposed to as a result of refusing to settle.

        - The insurer's refusal to properly investigate the claim and potential defenses.

        - The information available to the insurer at the time the demand for settlement was made. *Smith v. General Acc. Ins. Co.*, 91 N.Y.2d 648 (N.Y. 1998).

    - When a third party brings an action against an insurer for failure to settle a case, damages in excess of policy limits will be allowed if the insurer's actions show a "'conscious or knowing indifference to the probability' of an excess verdict." *Pinto v. Allstate Ins. Co.*, 221 F.3d 394, 400 (2d Cir. 2000) (citing *Pavia*, 626 N.E.2d 24).

- What are the applicable statutes of limitations?

    - 6 years: CPLR § 213; accrues at the entry of the judgment in the underlying action. *Roldan v. Allstate Ins. Co.*, 149 A.D.2d 20, 544 N.Y.S.2d 359 (2d Dept. 1989).

- What are recoverable damages for the bad faith cause of action?

    - The measure of damages for a solvent insured is the amount by which the judgment in the underlying tort action exceeds the insured's policy coverage. *DiBlasi v. Aetna Life & Cas. Ins. Co.*, 147 A.D.2d 93. This measure of damages may not apply to an insolvent insured.

NORTH CAROLINA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - N.C.G.S. §58-63-10: Unfair methods of competition or unfair and deceptive acts or practices prohibited.

        - §58-63-15(11): defines unfair methods of competition and unfair or deceptive acts or practices with respect to insurance.

        - §58-63-15(11): states that a violation of this subsection does not create a cause of action in favor of any person other than the [Insurance] Commissioner. However, a violation of §58-63-15(11) is considered a *per se* instance of unfair and deceptive trade practice under N.C.G.S. §75-1.1, which states that "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful. "*Murray v. Nationwide Mut. Ins. Co.*, 123 N.C.App. 1, 10, 472 S.E.2d 358, 363 (1996).

        - In order for an insured to prevail on a claim for unfair or deceptive trade practices, the insured must demonstrate "(1) an unfair or deceptive act or practice, or unfair method of competition, (2) in or affecting commerce, and (3) which proximately causes actual injury to the [insured] or his business," and (4) that the insurer engages in the conduct with such frequency as to indicate a general practice. *Cash v. State Farm Mut. Auto. Ins. Co.*, 137 N.C.App. 192, 197, 528 S.E.2d 372, 375, *disc. rev. granted*, 352 N.C. 147, 544 S.E.2d 223, *aff'd*, 353 N.C. 257, 538 S.E.2d 569 (2000).

- Under North Carolina law, the remedy for a violation of the statute proscribing unfair and deceptive trade practices by an insurer is the filing of a claim under the Unfair and Deceptive Trade Practices Act (UDTPA) (i.e., N.C.G.S. §75-1.1). However, the insured is not required to allege a violation of the insurance statute in order to bring a claim pursuant to UDTPA. *Country Club of Johnston County, Inc. v. United States Fid. And Guar. Co.*, 150 N.C.App. 231, 244, 563 S.E.2d 269, 278 (2002).

    - Advocating a position that is ultimately determined to be incorrect does not necessarily demonstrate a lack of good faith in attempting to settle an insurance claim under North Carolina law. *Cent. Carolina Bank and Trust Co. v. Sec. Life of Denver Ins. Co.*, 247 F.Supp.2d 791, 801 (M.D.N.C. 2003); *Cockman v. White*, 76 N.C.App. 387, 389, 333 S.E.2d 54, 55 (1985).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Plaintiff may file an action in both TORT and CONTRACT. In general, North Carolina follows the California case of *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566 (1973).

        - A bad faith breach of an insurance contract is indicated by "evidence which tends to show that [insurer's] refusal to pay or settle [insured's] claim on any reasonable basis was not based on honest disagreement or innocent mistake." *Dailey v. Integon Gen. Ins. Corp.*, 75 N.C.App. 387, 396, 331 S.E.2d 148, 155 (1985).

- What are the applicable statutes of limitations?

    - There is a four-year statute of limitations for unfair and deceptive trade practices that commences when the violations occur. *Neugent v. Beroth Oil Co.*, 149 N.C. App. 38, 54, 560 S.E.2d 829, 840 (2002); N.C.G.S. § 75-16.2.

    - There is a three-year statute of limitations for breach of contract. N.C.G.S. § 1-52.

- The North Carolina Court of Appeals held that a claim against an insurer for unfair or deceptive trade practices could proceed, even though the three-year statute of limitations barring claims for breach of contract, breach of fiduciary duty, and bad faith had run; the claim for unfair or deceptive practices was separate and distinct and governed by a four-year statute of limitations. *Page v. Lexington Ins. Co.*, 177 N.C.App. 246, 250, 628 S.E.2d 427, 430 (2006).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - In North Carolina, the "Genuine dispute of fact" defense is available since the courts follow *Gruenberg*. *See Cockman v. White*, 76 N.C.App. 387, 390, 333 S.E.2d 54, 55 (1985) (holding that a misunderstanding between plaintiff and defendant insurer was insufficient to constitute a deceptive practice).

- What are the recoverable damages for the bad faith cause of action?

  - Damages for both TORT & CONTRACT may be awarded. Additionally, tortious conduct accompanying a breach may give rise to both punitive damages and damages for emotional distress, if sufficient calculated intentional conduct is alleged. *See Von Hagel v. Blue Cross & Blue Shield*, 91 N.C. App. 58, 63, 370 S.E.2d 695, 699-700 (1988).

  - Treble damages and attorney's fees may also be awarded under UDTPA. N.C.G.S. §§ 75-16, 16.1.

  - "Plaintiffs may in proper cases elect to recover either punitive damages under a common law claim or treble damages under N.C.G.S. § 75-16, but they may not recover both." *United Lab. v. Kuykendall*, 102 N.C. App. 484, 492**,** 403 S.E.2d 104, 110 (1991) (quoting *Ellis v. Northern Star Co.*, 326 N.C. 219, 227, 388 S.E.2d 127, 132, *r'hrg denied*, 326 N.C. 488, 392 S.E.2d 89 (1990)).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Punitive damages ARE available.

- Punitive damages are capped at three times the amount of compensatory damages or $250,000, whichever is greater. N.C.G.S. §1D-25.

- "In order to recover punitive damages for the tort of an insurance company's bad faith refusal to settle, the plaintiff must prove (1) a refusal to pay after recognition of a valid claim, (2) bad faith, and (3) aggravating or outrageous conduct." *Lovell v. Nationwide Mut. Ins. Co.*, 108 N.C.App. 416, 420, 424 S.E.2d 181, 184 (1993).

- Notwithstanding the general rule that punitive damages are not allowed for breach of contract, "if there is also an identifiable tort, even if the tort constitutes or accompanies a breach of contract, that tort may give rise to a claim for punitive damages." *Von Hagel v. Blue Cross and Blue Shield of North Carolina*, 91 N.C. App. 58, 61, 370 S.E.2d 695, 698 (1988).

- The payment of policy limits within the time frame of an insurance policy does not preclude an action for punitive damages for tortious conduct, if bad-faith, delay, and aggravating conduct is present. *Robinson v. N.C. Farm Bureau Ins. Co.*, 86 N.C. App. 44, 50, 356 S.E.2d 392, 395 (1987).

- Are punitive damages insurable?

  - Punitive damages are insurable for wanton or grossly negligent conduct unless properly excluded. *Mazza v. Medical Mut. Ins. Co.*, 311 N.C. 621, 631, 319 S.E.2d 217, 223 (1984). However, the Supreme Court of North Carolina did not decide whether the consequences of intentional conduct could be insured. *Id.* at 626, 319 S.E.2d at 220.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - This question has not been addressed directly by North Carolina courts. However, a North Carolina court may allow an insured to recover punitive damages assessed if the insurer fails to settle due to bad faith based on the precedent set in *Mazza* that punitive damages

are insurable in certain circumstances. Additionally, when an insurer breaches its contract with an insured by denying liability or refusing to settle, the insurer waives the provisions defining the duties and obligations of the insured. *Nixon v. Liberty Mut. Ins. Co.*, 255 N.C. 106, 111-12, 120 S.E.2d 430, 435 (1961). Once an insurer unjustifiably refuses to defend, it must "pay the amount of the judgment rendered against the insured or of any reasonable compromise or settlement made in good faith by the insured of the action brought against him by the injured party." *Id.* at 111, 120 S.E.2d at 434.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - No.

    - North Carolina courts have not addressed whether a conflict between an insurer and an insured give the insured a right to an insurer-paid independent counsel.

    - However, North Carolina courts and the North Carolina State Bar have confirmed that an attorney's primary allegiance in a dual representation must remain with the insured. *Nationwide Mut. Fire Ins. Co. v. Bourlon*, 172 N.C. App. 595, 602, 617 S.E.2d 40, 45 (2005). Additionally, the North Carolina State Bar has issued several opinions on representing both the insured and the insurer. The North Carolina State Bar has suggested in several instances that it is appropriate to advise both clients to consider separate counsel on limited questions that present a conflict. *See* North Carolina State Bar RPC 92 (1991); North Carolina State Bar RPC 111 (1991); North Carolina State Bar RPC 112 (1991).

    - While independent counsel is not required, it is advisable in certain situations.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Generally, no. Under North Carolina law, an insurer can only defend its insured by retaining independent counsel. Under the typical defense counsel arrangement, appointed counsel are independent

contractors and any negligence cannot be imputed to the insurer. This does not preclude a direct claim against the insurer for negligent selection of independent counsel. *Brown v. LumbermensMut. Cas. Co.*, 90 N.C. App. 464, 473, 369 S.E.2d 367, 372 (1988).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. *Wilson v. Wilson*, 121 N.C.App. 662, 665, 468 S.E.2d 495, 497 (1996) (holding that North Carolina does not recognize a cause of action for third-party claimants against the insurance company of an adverse party based on UDTPA).

    - However, once a claimant obtains a judgment, it might be able to bring a claim under UDTPA based on post-judgment conduct. *Murray v. Nationwide Mut. Ins. Co.*, 123 N.C. App. 1, 17-20, 472 S.E.2d 358, 367-69 (1996).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No.

    - However, once a plaintiff obtains a judgment, it might be able to bring a claim for tortious breach of contract based on post-judgment conduct. *Murray v. Nationwide Mut. Ins. Co.*, 123 N.C.App. 1, 17-20, 472 S.E.2d 358, 367-69 (1996).

NORTH DAKOTA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No. *Dvorak v. American Fam. Mut. Ins. Co.,* 508 N.W.2d 329, 331 (ND 1993); *Volk v. Wisconsin Mtg. Assur. Co*., 474 N.W.2d 40 (N. D. 1991).

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - The law in this area is unsettled. North Dakota has adopted a statute governing unfair methods of competition and unfair or deceptive acts or practices. ND Cent. Code § 26.1-04-03. However, North Dakota courts have not addressed the issue of whether this statute creates a cause of action. It would appear that the statute may be used as evidence of a standard of conduct. A reasonable decision to pursue a matter through litigation, rather than settle, is not bad faith. *Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co.,* 279 N.W.2d 638 (ND 1979).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. *See, e.g., Olson v. Union Fire Ins. Co.,* 174 Neb. 375, 118 N.W.2d 318 (ND 1962); *Smith v. American Fam. Mut. Ins. Co.,* 294 N.W.2d 751 (ND 1980); *Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co.,* 279 N.W.2d 638 (ND 1979) following *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566 (1973).

- What are the applicable statutes of limitations?

    - Six (6) years, as for torts generally. ND Cent. Code § 28-01-16(5); *Bender v. Time Ins. Co.,* 286 N.W.2d 489 (ND 1979).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - The law on defenses potentially unique to claims of bad faith is unsettled. No North Dakota cases appear to have addressed such topics. However, not every unsuccessful decision of an insurer to litigate a claim is bad faith. *Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co.,* 279 N.W.2d 638. 645 (ND 1979).

- What are the recoverable damages for the bad faith cause of action?

    - Damages for breach of contract, pecuniary loss. *Vallejo v. Jamestown College*, 244 N.W.2d 753 (ND 1976). Damages proximately caused by the bad faith. *Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co.,* 279 N.W.2d 638. 643 (ND 1979). Otherwise, the matter is unsettled.

    - *Olson v. Union Fire Ins. Co.,* 174 Neb. 375, 118 N.W.2d 318, 320-21 (ND 1962) ("The liability of an insurer to pay in excess of the face of the policy accrues when the insurer, having exclusive control of settlement, in bad faith refuses to compromise a claim for an amount within the policy limit." Court found no bad faith in refusing to settle within limits.).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes, where malice, wantonness or oppression are proven. *Vallejo v. Jamestown* College, 244 N.W.2d 753 (ND 1976); *Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co.,* 279 N.W.2d 638, 645 (ND 1979).

- Are punitive damages insurable?

    - Insuring punitive damages is against public policy, but if a policy can be interpreted to include them then the insurer must pay them subject to having an indemnity action against the insured to recover them back. *Continental Cas. Co. v. Kinsey*, 499 N.W.2d 574 (ND 1993), held that punitive damages were covered due to ambiguity in policy caused by waiver of punitive damages

exclusion even though North Dakota's public policy is to the contrary. So the insurer could seek indemnity from the insured for punitive damages paid.

- *Nodak Mut. Ins. Co. v. Heim*, 559 N.W.2d 846 (N.D. 1997): Public policy bars coverage for intentional acts, and since the insurance policy does not expressly include such coverage it is construed to exclude coverage for intentional acts by the insured.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - No case has decided this issue.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

  - No such cause of action has been recognized.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

  - No such cause of action has been recognized.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - No such cause of action has been recognized.

OHIO

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions?

    - No. Ohio Admin. Code § 3901-1-07, Unfair Trade Practices, lays out the 16 possible ways an insurance company can engage in unfair insurance practices. However, ORC §§ 3901.20, 3901.21 and OAC 3901-1-07, which set forth prohibited unfair or deceptive trade practices in the insurance industry, do not create an implied private cause of action in favor of the insureds. *Strack v. Westfield Companies* (Ohio App. 9 Dist., 11-26-1986) 33 Ohio App. 3d 336, 515 N.E. 2d 1005; *Fletcher v. Nationwide Mut. Ins. Co.* (Ohio App. 2d Dist., June 13, 2003), 2003 Ohio 3038.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. *Zoppo v. Homestead Ins. Co.* (1994), 71 Ohio St. 3d 552, is the lead Ohio case.

        - Standard used to decide whether an insurer has breached its duty to its insured to act in good faith: An insurer fails to exercise good faith in the processing of a claim where its refusal to pay the claim is not predicated upon circumstances that furnish reasonable justification therefore.

        - This decision reaffirmed the standard first set forth in *Hart v. Republic Mut. Ins. Co.* (1949), 152 Ohio St. 185, and reaffirmed

in *Hoskins v. Aetna Life Ins. Co.* (1983), 6 Ohio St. 3d 272 and *Staff Builders, Inc. v. Armstrong* (1988), 37 Ohio St. 3d 298.

- *Netzley v. Nationwide Mut. Ins. Co.*, 34 Ohio App. 2d 65 (2d Dist. Montgomery County 1971): Succinctly describes bad faith law in Ohio:

    - Where there has been a negligence action brought against insured and a petition prays for an amount which exceeds limits of policy, insurer must exercise good faith toward insured in negotiating a settlement.

    - In determining whether insurer has exercised good faith toward insured, factors to be considered that are basic to a proper defense of any negligence action include appropriate conferences between trial counsel and client, that there is appropriate investigation of circumstances of incident out of which negligence claim arose, that advisory opinion as to applicable law must be made by legal counsel involved, and that there should be formulated by insurer and its counsel a general determination as to degree of liability, if any, of insured, and such information should be conveyed to insured.

    - In a negligence action where defense of a claim has been subrogated pursuant to an insurance contract, facts which are indicative of bad faith on the part of an insurer toward its insured in its negotiations with a claimant concerning a settlement of the controversy set forth are: the insurer recognizes the advisability of settlement, but attempts to get the insured to contribute thereto; the insurer refuses to discuss the acceptability of a contribution on the part of the insured; the insurer fails to properly investigate the claim so as to be able to intelligently assess all of the probabilities of the case; the insurer rejects the advice of its attorneys and/or agents urging a settlement; the insured receives a compromise offer within or near the policy limit, but fails to act in any fashion upon it; after receiving a reasonable compromise offer of settlement, the insurer offers an

unreasonably low settlement sum at the time of trial; and the insurer fails to inform the insured of any compromise offer.

- Insurer, when defending action against insured, was not bound to act in a fiduciary relation to insured.

- What is the applicable statute of limitations?

  - 4 year statute of limitations. See, *United Dept. Stores Co. v. Continental. Cas.* (Ohio App. 1st Dist., 1987), 41 Ohio App. 3d 72.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - The "reasonable justification" standard is used in Ohio; insurer must have a reasonable justification for its refusal to pay the claim of its insured. *Zoppo v. Homestead Ins. Co.* (1994), 71 Ohio St. 3d 552.

  - Legitimate Question of Liability on Claim: Evidence indicates that the policy has lapsed: *Tokles & Son, Inc. v. Midwestern Indem. Co.*, 65 Ohio St. 3d 621, 605 N.E. 2d 936 (1992).

- What are the recoverable damages for the bad faith cause of action?

  - Compensatory, punitive and possible attorney fees if punitive damages are awarded. *Zoppo v. Homestead Ins. Co.* (1994), 71 Ohio St. 3d 552.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. *Zoppo v. Homestead Ins. Co.* (1994), 71 Ohio St. 3d 552.

  - Punitive damages may be recovered against an insurer who breaches its duty of good faith to pay a claim upon proof of actual malice, fraud or insult on part of the insurer. "Actual malice" is defined as (1) that state of mind under which a person's conduct is characterized by hatred, ill will, or a spirit of revenge, or (2) a conscious disregard for the rights and safety of other persons that has a great probability of causing substantial harm.

- Attorney fees may be awarded as an element of compensatory damages where the jury finds that punitive damages are warranted.

- Are punitive damages insurable?

  - The Ohio Supreme Court has repeatedly held that public policy prevents insurance contracts from insuring against claims for punitive damages based upon an insured's malicious conduct. In addition, R.C. 3937.182(B) prohibits insurance coverage of punitive damages: "No policy of automobile or motor vehicle insurance shall provide coverage for judgments or claims against an insured for punitive or exemplary damages." *Neal-Pettit v. Lahman*, 125 Ohio St. 3d 327, 331 (2010). Because R.C. 3937.182(B) mentions only punitive and exemplary damages and the General Assembly chose not to mention attorney fees when it drafted the statute, the Ohio Supreme Court held that attorney fees that are awarded in connection with a punitive damages award are recoverable from an insurance carrier. *Id.*

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - In *Zoppo v. Homestead Ins. Co.* (1994), 71 Ohio St. 3d 552, 558, the Ohio Supreme Court held: "[A]n insurer who acts in bad faith is liable for those compensatory damages flowing from the bad faith conduct of the insurer and caused by the insurer's breach of contract." The issue of whether an award of punitive damages against an insured is considered as flowing from the bad faith conduct of the insurance carrier has not been addressed by the Ohio courts.

  - In *Buckeye Union Ins. Co. v. New Eng. Ins. Co.* (1999), 87 Ohio St. 3d 280, the Ohio Supreme Court was asked to answer the following certified question from the U.S. district court. "When an insurance company is found by Ohio courts to be guilty of 'bad faith' with 'actual malice' because it failed to settle a tort case against its insured, does such conduct constitute the type of intentional tort

that is uninsurable under Ohio law?" The Court concluded, "We find that an insurer found to be guilty of bad faith with actual malice in failing to settle a tort case against its insured is not necessarily guilty of the type of intentional tort that is uninsurable under Ohio law." *Id.* at 283. The Court reasoned that since the there was not a finding the insurance company (Buckeye Union) acted with an intent to injure, its bad-faith failure to settle the insurance claim was itself not necessarily an uninsurable act.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - In Ohio an insurer can defend with its appointed counsel under a reservation of rights unless "the insurer's interests and those of its insured are mutually exclusive." *Red Head Brass, Inc. v. Buckeye Union Ins. Co.*, 135 Ohio App.3d 616, 626 (Ohio Ct. App. 1999) ("The mere fact that certain claims fell outside the policy coverage, as explained in the reservation-of-rights letter, did not obligate Buckeye to pay for Red Head's private legal expenditures because Buckeye, through GSFN, was able to defend Red Head." (*Id.* at 626-27)).

    - *Socony-Vacuum Oil Co. v. Continental Cas. Co.*, 144 Ohio St. 382, 397 (1945) ("As the hazard was created by the action of the insurer in placing itself in a position in which it could not and did not fully and completely perform its contractual obligation to make defense, the insured is entitled to recover reasonable attorney fees, and proper expenses on the ground that insurer breached its contract.")

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - In general, an insurer cannot be held directly liable for legal malpractice. In *Nat'l Union Fire Ins. Co. v. Wuerth*, 540 F. Supp.2d 900 (S.D. Ohio 2007), the U.S. District Court for the Southern District of Ohio, while analyzing Ohio state law concluded, "a 'direct claim' for legal malpractice cannot be asserted against a non-attorney." *Id.* at 913. In reaching this conclusion, the court noted, "[i]t is a fundamental maxim of law that a person cannot be held liable, other than derivatively, for another's negligence." *Id.* at 913.

In a related case, the Ohio Supreme Court held that a law firm (as an entity) does not engage in the practice of law and therefore cannot commit legal malpractice directly and that a law firm is not vicariously liable for legal malpractice unless one of its principals or associates is liable for legal malpractice. *Nat'l Union Fire Ins. Co. v. Wuerth*, 122 Ohio St. 3d 594 (2009). The legal principals enunciated by the Ohio Supreme Court in the *Wuerth* decision could be extended to bar direct liability against an insurer for legal malpractice of appointed counsel. Additionally, Ohio courts have consistently held that malpractice by any other name still constitutes malpractice, making such claims subject to the one year statute of limitations for malpractice. *Rumley v. Buckingham, Doolittle & Burroughs*, 129 Ohio App.3d 638, 641, 718 N.E.2d 964, 967 (1998*); Muir v. Hadler Real Estate Mgmt. Co.*, 4 Ohio App.3d 89, (1982).

- While an insurer cannot be held directly liable for the legal malpractice of assigned defense counsel, an insurer under certain circumstances can be held vicariously liable for defense counsel's malpractice. If there is evidence to show that an insurance company interfered with the strategy of the counsel it retained, then under a given fact scenario, such counsel might not be found to be an independent contractor and the insurer could be vicariously liable under such circumstances. *Mentor Chiropractic Ctr. v. State Farm Fire & Cas. Co.*, 139 Ohio App. 3d 407, 412 (2000), *citing Junction Auto Sales, Inc. v. Universal Underwriters Ins. Co.*, 1991 Ohio App. LEXIS 5323, 11-13 (Nov. 8, 1991). In *Junction Auto Sales,* the Ohio appellate court concluded, "under certain conditions, the relationship between an insurer and retained counsel may become an agency relationship. However, the relationship will be regarded initially as one of an independent contractor. The onus is then placed upon the insured to establish that the relationship between the insurer and retained counsel is an agency as opposed to an independent contractor." *Id.* There are no Ohio cases where the relationship of insurer and retained defense counsel was considered an agency rather than an independent contractor.

- In *Mentor Chiropractic Ctr. v. State Farm Fire & Cas. Co.*, 139 Ohio App. 3d 407, 412 (2000), the court stated, "We do not accept the claim that vicarious liability falls on one who retains independent

trial counsel to conduct litigation on behalf of a third party when retained counsel have conducted the litigation negligently. In our view independent counsel retained to conduct litigation in the courts act in the capacity of independent contractors responsible for the results of their conduct and not subject to the control and direction of their employer over the details and manner of their performance. By its very nature the duty assumed by [the insurance company] to defend its assured against suits must necessarily be classified as a delegable duty, understood by all parties as such, for [the insurance company] had no authority to perform that duty itself and, in fact, was prohibited from appearing.' [Citations omitted.]." See also, *Belcher v. Dooley*, 1988 WL 15647 (Ohio Ct. App., Feb. 16, 1988, 10444) (unpublished) (adopting result in *Merritt v. Reserve Ins. Co.* (1973) 34 C.A.3d 858, that insurer is not vicariously liable for malpractice of defense counsel).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Ohio Courts have repeatedly held that a third-party claimant cannot assert bad-faith claims against an insurer. *Gilette v. Estate of Gilette* (2005), 163 Ohio App. 3d 426.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No, see above.

OKLAHOMA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes

- Can third parties sue for bad faith (i.e., third party bad faith)? No. (Caveat: Class II insured can sue regarding automobile coverage.)

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. The Unfair Claims Settlement Practices Act, 36 Okl.St.Ann. §§ 1221-1228, does not create a private cause of action. *Walker v. Chouteau Lime Co., Inc.*, 849 P.2d 1085 (1993).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. In *Christian v. American Home Assur. Co.*, 577 P.2d 899, 1977 Okla. 141 (1977), the Supreme Court of Oklahoma held an insurer has an implied duty to deal fairly and act in good faith with its insured.

    - Oklahoma law provides for tort claims against insurers when there is a clear showing that the insurer acted unreasonably, and in bad faith. *VBF, Inc. v. Chubb Group of Ins. Companies*, 263 F.3d 1226 (10th Cir. Okla.,2001).

    - The level of culpability required for bad faith is more than simple negligence, but less than the reckless conduct necessary to sanction a punitive damage award. *Badillo v. Mid Century Ins. Co.*, 121 P.3d 1080, 1093 (Okla.2005).

- What are the applicable statutes of limitations?

- Two years. 12 Okl.St.Ann. § 95.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - In *Christian v. American Home Assur. Co*., 577 P.2d 899, 1977 Okla. 141 (1977), the court recognized that an insurer would not be deemed in bad faith simply because it disputed its insured's claim even to the point of litigation, but rather would be subject to such liability only upon a "clear showing" that the insurer unreasonably and in bad faith withheld payment of its insured's claim.

  - A bad faith action against an insurer will not lie where there is a legitimate dispute. *Sims v. Travelers Ins. Co*., 16 P.3d 468, (Okla. Civ. App. Div.1 2000).

  - Advice of counsel: In *Barnes v. Oklahoma Farm Bureau Mut. Ins*. Co., 11 P.3d 162 (2000), the Court did not hold that advice of counsel was, or was not, a defense in all cases, but ruled that here, where advice conflicted directly with established law, insurer's conduct was unreasonable.

- What are the recoverable damages for the bad faith cause of action?

  - All provable consequential damages may be recovered. *Christian v. American Home Assur. Co*., 577 P.2d 899, 1977 Okla. 141 (1977). If the insurer has breached its duty to defend, it, like any other party to a contract who has failed to perform, becomes liable for all foreseeable damages that flow from the breach, including attorney fees. *First Bank of Turley v. Fid & Deposit Ins. Co. of Md*., 928 P.2d 298 (Okla. 1996).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. 23 Okl.St.Ann. § 9.1 provides a three tier system for punitive damages. A separate proceeding is conducted by the jury which must decide whether to award punitive damages, and their amount. The below discussion is limited to the effect on insurance litigation.

Category I requires a finding by the jury of clear and convincing evidence that an insurer recklessly disregarded its duty to deal fairly and act in good faith with its insured. Punitive damages are limited to the greater of $100,000, or the actual damages awarded. The statute does not define "reckless disregard," but the Oklahoma Uniform Jury Instructions provide: The conduct of [Defendant] was in wanton or reckless disregard of another's rights if [Defendant] was either aware, or did not care, that there was a substantial and unnecessary risk that [his/her/its] conduct would cause serious injury to others. In order for the conduct to be in wanton or reckless disregard of another's rights, it must have been unreasonable under the circumstances, and also there must have been a high probability that the conduct would cause serious harm to another person.

Category II requires a finding by the jury of clear and convincing evidence that an insurer intentionally and with malice breached its duty to deal fairly and act in good faith with its insured. The statute does not define "malice," but the Oklahoma Uniform Jury Instructions provide: "Malice involves either hatred, spite, or ill-will, or else the doing of a wrongful act intentionally without just cause or excuse." Punitive damages are limited to the greater of $500,000, twice the amount of actual damages, or the increased financial benefit the insurer derived as a direct result of the conduct. The last measure concerning the financial benefit to the defendant is subject to reduction by the amount that the defendant has already paid in punitive damages in Oklahoma state court actions to other defendants on account of the same conduct.

Category III requires a finding by the jury by clear and convincing evidence an insurer intentionally and with malice breached its duty to deal fairly and act in good faith with its insured. In addition, the judge must find there is evidence beyond a reasonable doubt that the defendant or insurer acted intentionally and with malice and engaged in conduct life-threatening to humans. If the appropriate findings are made by both the judge and the jury, the judge may lift the cap on punitive damages. (This would, however, be subject to due process limitations as set forth by the United States Supreme Court.)

Once the appropriate Category has been selected, the jury must then determine the amount of punitive damages. The statute lists a number of factors to govern the award of punitive damages. These are:

1. The seriousness of the hazard to the public arising from the defendant's misconduct;

2. The profitability of the misconduct to the defendant;

3. The duration of the misconduct and any concealment of it;

4. The degree of the defendant's awareness of the hazard and of its excessiveness;

5. The attitude and conduct of the defendant upon discovery of the misconduct or hazard;

6. In the case of a defendant which is a corporation or other entity, the number and level of employees involved in causing or concealing the misconduct; and

7. The financial condition of the defendant.

- Are punitive damages insurable?
    - The policy provision "for all sums which the insured might become legally obligated to pay" is sufficiently broad to include liability for punitive damages. *Dayton Hudson Corp. v. American Mut. Liability Ins. Co.*, 621 P.2d 1155, 1158 (Okla. 1980).
    - Public policy, however, generally forbids insurance coverage for punitive damages. *Dayton Hudson Corp. v. American Mut. Liability Ins. Co.*, 621 P.2d 1155, 1160 (Okla. 1980) ("Giving full effect to the purpose punitive damages must serve, we hold that a culpable party is not to be permitted to escape the civil consequences of its wrong.")

- There is an exception to the public policy where the insured's liability for punitive damages is wholly based on others' conduct. *Dayton Hudson Corp. v. American Mut. Liability Ins. Co.*, 621 P.2d 1155, 1160 (Okla. 1980) ("public policy against insurance protection for punitive damages does not preclude recovery of indemnity from the insurer by an employer to whom either willfulness or gross negligence of his harm-dealing employee became imputable for imposition of liability under the Oklahoma application of the respondeat superior doctrine.").

- "Oklahoma courts adhere to the view that public policy prohibits liability insurance coverage of punitive damages except where the party seeking the benefit of insurance coverage has been held liable for punitive damages solely due to conduct of another, under principles of vicarious liability." *Magnum Foods, Inc. v. Continental Cas. Co.*, 36 F.3d 1491, 1497 (10th Cir. 1994).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - While this question has not been directly answered by Oklahoma courts, one case that is very instructive on the matter is *Magnum Foods v. Continential Casualty Company*, 36 F.3d 1491 (10th Cir. 1994). In that case, Magnum lost a jury verdict which included punitive damages. Demand was previously made upon Continental by Magnum to settle within policy limits and for a lesser amount than was awarded by the jury. Continental refused, and a bad faith action was subsequently brought by Magnum seeking damages for failure to settle, thus exposing Magnum to punitive liability. The court found that Continental was not liable for punitive damages in that the award had been based solely on the conduct of Magnum itself. And in assessing whether to settle, Continental was not obligated to treat the potential of an uncovered punitive damages claim the same as it would a covered claim that could lead to a judgment in excess of limits. However, had the punitive damage award been based on Magnum's vicarious liability for the acts of one of its employees, coverage for those damages would exist under Oklahoma law, thus, likely exposing the insurer to liability for them as damages resulting from it refusal to settle.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - Under some circumstances independent counsel is required. In *Nisson v. American Home Assur. Co.*, 917 P.2d 488 (Okla. App. 1996), the Court required the insurer to pay defense costs for the independent representation of the insured where the insurer had a conflict with the insured's defense strategy, not merely where the issue was the extent of coverage.

        - "Independent counsel is only necessary in cases where the defense attorney's duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds that would render the insurer liable." *Id.* at 490.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - There is no specific authority in Oklahoma on this point.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Generally, there is no third-party bad faith. A true third party lacks standing to sue for bad faith. *Allstate Ins. Co. v. Amick*, 680 P.2d 362 (Okla. 1984).

    - In *Townsend v. State Farm Mutual Automobile Insurance Company*, 860 P.2d 236 (Okla. 1993), the Oklahoma Supreme Court held that

an insurer had a duty to act in good faith and deal fairly with its insureds' class 2 insured passenger covered by the named insured's uninsured motorist policy. The case did not extend privity to someone who was not connected to the insured either by contract or statute.

OREGON

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.
- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.
    - No. "[T]he violation of [Oregon's Unfair Trade Practices Act] ORS 746.230(1)(f), which requires insurers to settle claims promptly and in good faith where their liability is reasonably clear, does not give rise to a tort action." *Employers' Fire Ins. Co. v. Love It Ice Cream Co.*, 64 Or. App. 784, 790, 670 P.2d 160 (1983).
- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.
    - Property and other non-liability policies: No.
        - *Employers' Fire Ins. Co. v. Love It Ice Cream Co.*, 64 Or. App. 784, 791, 670 P.2d 160 (1983).
            - "[A]n insurer's bad faith refusal to pay policy benefits to its insured sounds in contract and is not an actionable tort in Oregon."
    - Liability insurance policies: Yes.
        - *Georgetown Realty v. Home Ins. Co.*, 313 Or. 97, 831 P.2d 7 (1992).
            - A negligence claim arises between contracting parties only when a standard of care exists independent of the contract. When a liability insurer agrees to defend the insured, "[t]he insured relinquishes control over the defense of the claim asserted. Its potential

monetary liability is in the hands of the insurer." This relationship carries an independent standard of care, and the insured can bring a claim in negligence for failure to meet that standard of care. *Id.* at 110.

- If the insurer undertakes to defend the insured, it has a duty to settle within the policy limits if it is reasonable to do so. The violation of this duty gives rise to a tort action. *Id.*

- *Goddard v. Farmers Ins. Co.*, 202 Ore. App. 79, 120 P.3d 1260 (2005) *aff'd as modified,* 344 Ore. 232, 179 P.3d645 (2008).

  - "Under Oregon law, an insurer owes a duty of care to its insured that includes a duty to make reasonable efforts to settle claims in order to avoid exposing the insured to liability in excess of policy limits." *Id.* at 85.

- *Warren v. Farmers Ins. Co. of Oregon*, 115 Or. App. 319, 838 P.2d 620 (1992).

  - If a liability insurer does not undertake to defend its insured, the insured may only recover contract damages, and the duty to exercise reasonable care does not arise. *Id.* at 324-25.

- What are the applicable statutes of limitations?

  - Bad faith actions sound in tort. The statute of limitations for tort claims is two years. ORS 12.110(1).

  - Breach of duty to defend sounds in contract. The statute of limitations for contract actions is 6 years. ORS 12.080(1).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Exercising reasonable care to protect the insured's interests is a defense to a bad faith claim. *Maine Bonding & Casualty Co. v. Centennial Ins. Co.*, 298 Or. 514, 519, 693 P.2d 1296 (1985).

- "[A]n insurer cannot be held liable for failure to settle within the policy limits when no reasonable opportunity to settle exists." *Main Bonding*, 298 Or. 514, 519, 693 P.2d 1296 (1985).

- The insurer's reasonable belief that the insured's exposure would be less than the available policy limits is a defense to a bad faith claim. *Eastham v. Or. Auto. Ins. Co.*, 273 Or. 600, 540 P.2d 895 (1975).

- "An insured's breach of the policy's cooperation clause, if proved, would provide a complete bar to recovery." *Stumpf v. Continental Casualty Co.*, 102 Ore. App. 302, 309, 794 P.2d 1228 (1990)

- What are the recoverable damages for the bad faith cause of action?

    - The insured can recover the amount of the judgment against the insured in excess of the policy limits where the insurer's failure to reasonably settle within the policy limits caused the excess judgment. *Goddard v. Farmers Ins. Co. of Oregon*, 173 Or. App 633, 637, 22 P.3d 1224 (2000).

    - Emotional distress damages may be recovered if the insurer's breach resulted in physical harm to the insured. *McKenzie v. Pacific Health & Life Ins. Co.*, 118 Or. App. 377, 381, 847 P.2d 879 (1993).

    - Attorney's fees may be recoverable in actions against an admitted insurer. ORS 742.061 provides the exclusive remedy for obtaining attorney fees in disputes arising out of insurance policies. "*[I]f settlement is not made within six months from the date proof of loss is filed with an insurer and an action is brought in any court of this state upon any policy of insurance of any kind or nature, and the plaintiff's recovery exceeds the amount of any tender made by the defendant in such action, a reasonable amount to be fixed by the court as attorney fees shall be taxed as part of the costs of the action and any appeal thereon.*" ORS 742.061.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - "*Punitive damages are not recoverable in a civil action unless it is proven by clear and convincing evidence that the party against whom punitive damages are sought has acted with malice or has shown a reckless and outrageous indifference to a highly unreasonable risk of harm and has*

acted with a conscious indifference to the health, safety and welfare of others." ORS § 31.730

- Punitive damages are recoverable for failure to settle claims under a liability policy. The insured plaintiff must prove by "clear and convincing evidence that defendant acted intentionally or recklessly to protect its own interests at the expense of plaintiff's and that it had ample reason to know that there was a great risk of an excess judgment against plaintiff if it did not avail itself of opportunities to settle the underlying action." *Georgetown Realty v. Home Ins. Co*., 113 Ore. App. 641, 645, 833 P.2d 1333 (1992).

- Conventionally, simple negligence cannot support an award of punitive damages, while breach of a fiduciary duty can, if evidence of aggravating factors is produced. *Georgetown Realty v. Home Ins. Co*., 113 Ore. App. 641, 644, 833 P.2d 1333 (1992).

- Punitive damages are subject to judicial review, and Oregon courts have set the maximum ratio of punitive damages to compensatory damages at 4:1 in cases where the damages were purely economic. *Goddard v. Farmers Ins. Co. of Oregon*, 344 Or. 232, 275, 179 P.3d 645 (2008).

- Are punitive damages insurable?

  - Punitive damages are insurable. *Harrell v. Travelers Indemnity Co*., 279 Or. 199, 567 P.2d 1013 (1997).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - There is no case directly on point, but, in general, the insured may recover all damages incurred due to a damage award in excess of policy limits. *Alexander Mfg. v. Illinois Union Ins. Co*., 666 F.Supp.2d 1185 (D. Ore 2009).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - No.

- However, Oregon courts address the potential conflict in a different way. Where there is a conflict of interest between insured and insurer, the rule of estoppel by judgment will not apply in any subsequent action by the insured for coverage, reasoning: "If the judgment in the original action is not binding upon the insurer or insured in a subsequent action on the issue of coverage, there would be no conflict of interests between the insurer and the insured in the sense that the insurer could gain any advantage in the original action which would accrue to it in a subsequent action in which coverage is in issue." *Ferguson v. Birmingham Fire Ins. Co.*, 254 Ore. 496, 510-11, 460 P.2d 342 (1969).

- The Oregon State Bar Ethics Association also issued a Formal Opinion stating that "the policyholder is the primary client whose protection must be the attorneys' dominant concern." Attorneys must "obtain the insured's consent before submitting bills to a third-party audit service for review." The Oregon State Bar recommends advising the insured to seek independent legal advice about whether consent should be given, or whether it may waive the attorney-client privilege. Attorneys are also advised to inform the insured that failure to give consent might be viewed as a failure to cooperate, which may constitute a breach of the policy. Attorneys may submit bills that do not contain client confidences to third parties. Oregon State Bar Ethics Association Formal Opinion No. 1999-157, June 1999.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

  - Yes. *Stumpf v. Continental Cas. Co.*, 102 Ore App. 302, 794 P.2d 1228 (1990). "Given [insurer's] contractual duty and the degree of control that it retained over [its insured's] defense, we apply what appears to be the rule in the majority of jurisdictions: An insurer may be vicariously liable for the actions of its agents including counsel that it hires to defend its insured."

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

- No. The Unfair Claims Practices Act, ORS 746.230, does not give rise to a tort action.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - The insured's contractual rights in an action on an insurance policy, including the right to expect the insurer to exercise good faith in settling claims, are assignable. If the insurer fails to reasonably settle within the policy limits, the insured may assign its rights against the insurer to the insured's judgment creditor. *Groce v. Fidelity Gen. Ins. Co.*, 252 Ore. 296, 302-03, 448 P.2d 554 (1968).

  - For purposes of a bad faith litigation by an assignee of the insured, the assignee stands in the shoes of the insured. The same standards discussed above apply to the assignee. *See Goddard v. Farmers Ins. Co.*, 202 Or. App. 79, 105, 120 P.3d 1260 (2005).

- What are the applicable statutes of limitations?

  - Same as First Party Bad Faith discussion, above. Two years for tort actions 6 years for contract actions. See that section for details.

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Same as First Party Bad Faith discussion, above. See that section for details.

- What are the recoverable damages for the bad faith cause of action?

  - Same as First Party Bad Faith discussion, above. See that section for details.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Same as First Party Bad Faith discussion, above. See that section for details.

PENNSYLVANIA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? Only with an assignment from the insured.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Pennsylvania's bad faith statute is found at 42 Pa. C.S. § 8371, which provides:

> *In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:*
>
> *(1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.*
>
> *(2) Award punitive damages against the insurer.*
>
> *(3) Assess court costs and attorney fees against the insurer.*

    - Insureds also frequently try to sue their insurers under Pennsylvania's Unfair Trade Practices and Consumer Protection Law ("UTPCPL"), 73 Pa. C.S. § 201-1, et seq. However, that statute only applies to goods or services purchased for personal family or household purposes; thus, a commercial insured cannot sue an insurer under the UTPCPL. *See, e.g., Novinger Group, Inc. v. Hartford Ins. Inc.,* 514 F.Supp.2d 662 (M.D. Pa. 2007); *Trackers Raceway, Inc. v. Comstock Agency, Inc.*, 583 A.2d 1193 (Pa. Super. 1990). Additionally, Pennsylvania courts have held that only malfeasance,

not nonfeasance, is actionable under the UTPCPL, and failure to pay a claim constitutes nonfeasance. *See, e.g., Gordon v. Pennsylvania Blue Shield*, 548 A.2d 600, 604 (Pa. Super. 1988); *Leo v. State Farm Mut. Auto. Ins. Co.*, 939 F. Supp. 1186 (E.D. Pa. 1996), *aff'd w/o opin.*, 116 F.3d 468 (3d Cir. 1997). The determination of whether a cause of action against an insurer is viable under the UTPCPL will depend on the facts of each individual case.

- Pennsylvania's Unfair Insurance Practices Act, 40 P.S. §§ 1171.1, et seq. does not permit a private cause of action. *See, e.g., D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 431 A.2d 966 (Pa. 1981); *Fay v. Erie Ins. Group*, 723 A.2d 712 (Pa. Super. 1999). Some courts have allowed its provisions to be considered evidence of bad faith, but that question is unresolved by the Pennsylvania Supreme Court. *Compare Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228 (Pa. Super. 1994) (permitting evidence of UIPA violations in statutory bad faith claim); and *Johnson v. Progressive Ins. Co.*, 987 A.2d 781 (Pa. Super. 2009) (noting that bad faith can also be proven based on failure to communicate with the insured and lack of investigation but finding no bad faith under the facts); *with Toy v. Metropolitan Life Ins. Co.*, 928 A.2d 186, 199 n.16 (Pa. 2007) (noting it was not deciding "whether an insurer's violations of the UIPA are relevant to proving a bad faith claim"). The courts likewise disagree as to whether evidence of violations of the UIPA may be used in an unfair trade practices suit. *Compare Pekular v. Eich,* 513 A.2d 427 (Pa. Super. 1986) (holding UIPA did not preclude UTPCPL claim based on insurance practices), *app. denied*, 533 A.2d 93 (Pa. 1987); *Parasco v. Pacific Indemnity Co.*, 870 F. Supp. 644 (E.D. Pa. 1994) (dismissing UTPCPL claim based on UIPA violations because court held determination of whether the UIPA had been violated was exclusively for the insurance commissioner); and *Leo v. State Farm Mut. Auto. Ins. Co.*, 908 F. Supp. 254 (E.D. Pa. 1995) (holding court could consider UIPA standards in UTPCPL claim).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Pennsylvania does not recognize a common law tort claim for bad faith. *D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 431 A.2d

966, 970 (Pa. 1981). However, a contractual claim for bad faith does exist. *Birth Center v. St. Paul Cos.*, 787 A.2d 376 (Pa. 2001) ("Where an insurer refuses to settle a claim that could have been resolved within policy limits without 'a bona fide belief . . . that it has a good possibility of winning,' it breaches its contractual duty to act in good faith and its fiduciary duty to its insured") (citing *Cowden v. Aetna Casualty & Surety Company*, 134 A.2d 223, 229 (Pa. 1957)).

- The standard applicable to contractual bad faith cases is somewhat unsettled, but guidance exists. The pronouncement quoted above from the *Birth Center* case was a refinement of the Supreme Court's *Cowden* decision, 134 A.2d at 228, which provided:

> [T]here is no absolute duty on the insurer to settle a claim when a possible judgment against the insured may exceed the amount of the insurance coverage. The requirement is that the insurer consider in good faith the interest of the insured as a factor in coming to a decision as to whether to settle or litigate a claim against the insured. What weight the insurer is duty-bound to accord to the interest of the insured is of course not determinable by any fixed legal standard or norm . . . The predominant majority rule is that the insurer must accord the interest of its insured the same faithful consideration it gives its own interest . . . But, that does not mean that the insurer is bound to submerge its own interest in order that the insured's interest may be made paramount.

Additionally, the federal district courts have discussed differences as to the standards for statutory versus contractual bad faith claims. *See McPeek v. Travelers Cas. & Sur. Co.*, No. 2:06-cv-114, 2007 U.S. Dist. LEXIS 46628 (W.D. Pa. 2007) (following *DeWalt v. The Ohio Cas. Ins. Co.*, No. 05-740, 2007 U.S. Dist. LEXIS 26901 (E.D. Pa. 2007), and holding both claims must be proven by clear and convincing evidence, but a contractual bad faith claim may be proven if the insurer's conduct was unreasonable or negligent); *CRS Auto Parts,*

Inc. v. Nat'l Grange Mut. Ins. Co., 645 F. Supp. 2d 354 (E.D. Pa. 2009) (discussing difference in statute of limitations and standards for statutory and contractual bad faith claims).

- What are the applicable statutes of limitations?

    - 2 years under the bad faith statute. *Ash v. Continental Ins. Co.*, 932 A.2d 877 (Pa. 2007).

    - A contractual bad faith claim has the same statute of limitations as any breach of contract claim, 4 years. *See Haugh v. Allstate Ins. Co.*, 322 F.3d 227 (3d Cir. 2003).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - If an insurer has not breached the contract, it should not be liable for bad faith. *See, e.g., First Philson Bank, N.A. v. Hartford Fire Ins. Co.*, 727 A.2d 584, 590-91 (Pa. Super. 1999) (court assumed that failure on the contract claim made bad faith claim moot), *appeal denied*, 747 A.2d 901 (Pa. 1999); *Continental Ins. Co. v. Alperin, Inc.*, 1998 U.S. Dist. LEXIS 5929 at 29-30 (E.D. Pa. 1998) ("Here, the insurer had no contractual obligation to provide coverage. Because the defendants' breach of contract and promissory estoppel claims fail on the merits, there is no cognizable bad faith claim."), *aff'd w/o opinion*, 1999 U.S. App. LEXIS 13521 (3d Cir. 1999).

    - If an insurer had a reasonable basis for denying benefits, even if incorrect, it should have no liability for bad faith. *See, e.g., Condio v. Erie Ins. Exchange*, 899 A.2d 1136 (Pa. Super. 2006) (reversing summary judgment in favor of insured on bad faith claim because evidence did not support finding as matter of law that insurer acted without reasonable basis), *appeal denied*, 912 A.2d 838 (Pa. 2006); *Hartman v. Motorists' Mut. Ins. Co.*, 2006 U.S. Dist. LEXIS 1719 (W.D. Pa. 2006) (despite finding coverage, court held insurer did not act in bad faith because its interpretation of the pollution exclusion clause was reasonable).

    - Mere negligence or bad judgment is insufficient for a finding of bad faith, at least under the bad faith statute. *See, e.g., Polselli v.*

Nationwide Mut. Fire Ins. Co., 23 F.3d 747, 751 (3d Cir. 1994); *Terletsky v. Prudential Property and Casualty Ins. Co.*, 649 A.2d 680, 688 (Pa. Super. 1994), *appeal denied* 659 A.2d 560 (Pa. 1995) (citations omitted).

- What are the recoverable damages for the bad faith cause of action?

    - Under Pennsylvania's bad faith statute, an insured may recover interest (prime rate) plus 3%, punitive damages and court costs and attorney's fees.
    - Compensatory damages are recoverable for contractual bad faith.
    - Under the UTPCPL, treble damages and attorney's fees are recoverable.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes, under Pennsylvania's bad faith statute. If bad faith under the statute is proven, no additional proof might be required for an award of punitive damages:

        - Section 8371, which creates the cause of action for insurance bad faith, specifically empowers the trial court to award punitive damages "if the court finds that the insurer has acted in bad faith toward the insured[.]" 42 Pa. C.S.A. § 8371. The statute provides no other language suggesting a pre-condition for the award of punitive damages. Thus, by statutory mandate, a finding of bad faith is the only prerequisite to a punitive damages award under section 8371. *See Atcovitz v. Gulph Mills Tennis Club, Inc.*, 571 Pa. 580, 812 A.2d 1218 (Pa. 2002) (reaffirming doctrine of statutory construction that inclusion of a specific matter in a statute implies the exclusion of other matters). Moreover, this Court has suggested that the elements of proof necessary to establish a claim for punitive damages under this section are co-extensive with those that establish the bad faith claim itself. *See Alberici v. Safeguard Mut. Ins. Co.*, 444 Pa. Super. 351, 664 A.2d 110, 115 (Pa. Super. 1995) (concluding that trial court properly denied claim for punitive damages under

section 8371 "because there was no evidence of bad faith to support an award of punitive damages"). This is not incongruous, given the similarity in elements required for a common law claim of punitive damages to those required to show statutory bad faith. *Compare Costa v. Roxborough Mem'l Hosp.*, 708 A.2d 490, 497 (Pa. Super. 1998) (prescribing "reckless indifference to the rights of others" as basis for imposition of punitive damages) *with Terletsky v. Prudential Property and Casualty Ins. Co.*, 649 A.2d 680, 687 (Pa. Super. 1994), *appeal denied* 659 A.2d 560 (Pa. 1995) (incorporating element of reckless conduct into definition of bad faith).

- However, a finding of bad faith does not compel the imposition of punitive damages.

  - "Although we recognize, as Erie argues, that a finding of bad faith does not compel an award of punitive damages, it does allow for the award without additional proof, subject to the trial court's exercise of discretion. *See* 42 Pa. C.S.A. § 8371. Accordingly, we find no merit in Erie's assertion that the trial court erred in not imposing a two-tiered standard of proof to sustain an award of punitive damages under section 8371." *Hollock v. Erie Ins. Exch.*, 842 A.2d 409, 418-19 (Pa. Super. 2004) (en banc), *appeal dismissed*, 903 A.2d 1185 (Pa. 2006). *See also Jurinko v. Medical Protective Co.*, 305 Fed. Appx. 13, 25 n.13 (3d Cir. 2008) (noting the Superior Court's holdings that punitive damages may be awarded without additional proof if bad faith is found and noting that the Third Circuit itself has not held that bad faith alone will always permit punitive damages, stating it "need not predict how the Pennsylvania Supreme Court would rule on this issue").

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - The mere issuance of a reservation of rights letter does not require the appointment of independent counsel, but if an actual conflict of

interest exists then the insured is entitled to the appointment of independent counsel. *See, e.g., Pennbank v. St. Paul Fire & Marine Ins. Co.*, 669 F. Supp. 122 (W.D. Pa. 1987); *Maddox v. St. Paul Fire & Marine Ins. Co.*, 2002 U.S. Dist. LEXIS 26686 at n.3 (W.D. Pa. 2002), *appeal dismissed*, 70 Fed. Appx. 77 (3d Cir. 2003). Whether or not an actual conflict exists will depend on the facts of each case. *Compare Pennbank* (holding no conflict of interest between insurer and insured requiring insurer to bear cost of independent counsel hired by insured where insurer denied liability for punitive damages because award of punitive damages would most likely be accompanied by a large compensatory damages award, thus the insurer's and the insured's interests were not in conflict) *with Rector v. American Nat'l Fire Ins. Co.*, 2002 U.S. Dist. LEXIS 625 (E.D. Pa. 2002) (conflict of interest existed where breach of fiduciary duty claim was covered but discrimination claim not covered and court concluded this was a situation where insurer could handle the defense in a way to make any damage award not covered).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - The bad faith statute only applies to insureds; thus, a third party cannot sue for bad faith without an assignment from the insured. *Johnson v. Beane*, 664 A.2d 96, 98-99 n.2-3 (Pa. 1995) (third-party plaintiff has no direct right of action against defendant's liability insurer for excess verdict without an assignment from the insured); *Brown v. Candelora*, 708 A.2d 104 (Pa. Super. 1998) (same), *appeal granted*, 725 A.2d 176 (1999), *appeal withdrawn*; *Strutz v. State Farm Mut. Ins. Co.*, 609 A.2d 569 (Pa. Super. 1992) (claimant not a third-party beneficiary to motor vehicle policy, thus, direct action against insurer by claimant dismissed), *appeal denied*, 615 A.2d 1313 (Pa. 1992). Pennsylvania has a direct action statute for claimants who cannot collect on a judgment against a bankrupt or insolvent insured, but recovery is limited to the limits of the policy. 40 P.S. § 117.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No, see above discussion regarding a third party only being able to sue for bad faith as an assignee of an insured.

RHODE ISLAND

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. General Laws of Rhode Island includes § 9-1-33 Insurer's Bad Faith Refusal to Pay a Claim Made Under Any Insurance Policy. Under § 9-1-33 "an insured . . . may bring an action against the insurer . . . when it is alleged the insurer wrongfully and in bad faith refused to pay or settle a claim made pursuant to the provisions of the policy, or otherwise wrongfully and in bad faith refused to timely perform its obligations under the contract of insurance." Claims under ERISA, however, are preempted. *Desrosiers v. Hartford Life & Accident Ins. Co.*, 354 F. Supp. 2d 119 (D.R.I. 2005) (citing *Ky. Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329 (2003)); *Morris v. Highmark Life Ins. Co.*, 255 F. Supp. 2d 16 (D.R.I. 2003).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313 (R.I. 1980). "To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. It is apparent, then, that the tort of bad faith is an intentional one. [I]mplicit in that test is our conclusion that the knowledge of the lack of a reasonable basis may be inferred and imputed

to an insurance company where there is a reckless disregard or a lack of a reasonable basis for denial or a reckless indifference to facts or to proofs submitted by the insured." *Id.* at 319 (citing *Anderson v. Cont'l Ins. Co.*, 271 N.W.2d 368, 376-77 (Wis. 1978)).

- What are the applicable statutes of limitations?

    - The applicable statute of limitations is not stated in the statute, and there is no Rhode Island decision on point. *Collins v. Fairways Condos. Ass'n*, 592 A.2d 147, 148 (R.I. 1991). The statute of limitations may be the statute applicable to different types of policies, for example one year on a fire insurance policy (R.I. Gen. Laws § 27-5-3), or three years on accident and sickness policies (R.I. Gen. Laws § 27-18-3). *Collins*, 592 A.2d at 148. The statute of limitations may also be the three year statute applicable to torts (R.I. Gen. Laws § 9-1-14(b)) or the ten year statute applicable to contracts (R.I. Gen. Laws § 9-1-13).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Rhode Island courts have recognized that "all facts and circumstances available to the insurer at the time it denied coverage under the policy" can be considered. *Skaling v. Aetna Ins. Co.*, 799 A.2d 997, 1015 (R.I. 2002). "If a claim is 'fairly debatable,' no liability in tort will arise." *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313, 319 (R.I. 1980). This is true whether the insurer ultimately loses a dispute in court regarding the validity of a claim or not. *Calenda v. Allstate Ins. Co.*, 518 A.2d 624, 628 (R.I. 1986). At least one court has found liability for statutory bad faith does not lie where the insurance policies were voided due to the insured's misrepresentations. *Borden v. Paul Revere Life Ins. Co.*, 935 F.2d 370 (R.I. 1991).

- What are the recoverable damages for the bad faith cause of action?

- An insurer acting in bad faith has opened itself up to a compensatory damages award (including for economic loss and emotional distress), punitive damages, and attorney's fees. *See* R.I. Gen. Laws § 9-1-33(a); *Skaling v. Aetna Ins. Co.*, 799 A.2d 997 (R.I. 2002); *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313, 319 (R.I. 1980).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes. Punitive damages are provided by statute with no heightened pleading necessary. See § 9-1-33(a); *Skaling v. Aetna Ins. Co.*, 799 A.2d 997 (R.I. 2002) ("Because punitive damages are available as a matter of right in bad faith cases, it is unnecessary to plead or prove willful or wanton conduct by the insurer.").

- Are punitive damages insurable?

    - Directly assessed punitive damages are not insurable under Rhode Island law. *Allen v. Simmons*, 533 A.2d 541 (R.I. 1987) (holding statutory law does not require insurer to indemnify for punitive damages in situations involving uninsured motorists). Whether vicariously assessed punitive damages are insurable is undecided.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - This issue has not been addressed by Rhode Island courts.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - In a pre-*Cumis* case, *Employers' Fire Ins. Co. v. Beals,* 103 R.I. 623, 240 A.2d 397, 404 (1968), the court specifically noted two proposals and said they were not the exclusive means of addressing this problem. *Beals* suggests the independent counsel approach, where counsel is appointed by the

insured and reimbursed by the insurer. The Court also suggests the appointment of two different attorneys. This latter alternative has been criticized as unworkable. See Richard L. Neumeier, *Serving Two Masters: Problems Facing Insurance Defense Counsel and Some Proposed Solutions*, 77 Mass. L. Rev. 66, 80 (1992) (discussing the *Beals* decision).

In a case decided by the U.S District Court for the District of R.I., applying Massachusetts law, the Court held:

> Unlike Rhode Island, Massachusetts has explicitly adopted a single approach, similar to the first alternative presented in *Beals,* appointment of independent counsel. *Compare Magoun,* 195 N.E.2d at 519, *with Beals,* 240 A.2d at 404. Additionally, defendant did not satisfy the *Beals* requirement that both attorneys be approved by the insurer. Plaintiff never approved the retention of Heald. *See Beals,* 240 A.2d at 404. If plaintiff had, this litigation would be unnecessary. *Hartford Cas. Ins. Co. v. A & M Associates, Ltd*. 200 F.Supp.2d 84, 91 -92 (D.R.I., 2002).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - This issue has not been addressed by Rhode Island courts.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. Rhode Island's bad faith statute only applies to claims by "an insured." R.I. Gen. Laws § 9-1-33.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- No. Rhode Island courts hold there is an adversarial relationship between an insurer and third parties, so there is no fiduciary duty owed to third parties. *Auclair v. Nationwide Mut. Ins. Co.*, 505 A.2d 431 (R.I. 1986); *Canavan v. Lovett, Schefrin & Harnett*, 745 A.2d 173, 174 (R.I. 2000).

SOUTH CAROLINA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. Although South Carolina Code of Laws includes § 38-59-20 *Improper Claims Practices*, in *Masterclean, Inc. v. Star Insurance Co*., 347 S.C. 405, 556 S.E.2d 371 (2001), the South Carolina Supreme Court held that third parties do not have a private right of action under § 38-59-20. The United States District Court for the District of South Carolina, predicting how the South Carolina Supreme Court would rule, held in *Ocean Winds Council of Co-Owners, Inc. v. Auto-Owners Ins. Co*., 241 F.Supp.2d 572 (2002), that the Improper Claims Practices Act did not create a first-party cause of action.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. In *Tyger River Pine Co. v. Maryland Casualty Co.*, 170 S.C. 286, 170 S.E. 346 (1933), the Supreme Court joined a number of jurisdictions in holding that an insurer's unreasonable refusal to settle within policy limits subjects the insurer to tort liability. In the *Tyger River* decision, the court also held, "The very thing which the appellant in the case which we have before us for determination undertook to do was to hold the respondent harmless in the disposition of Chesser's claim. If, in the effort to do this, its own interests conflicted with those of respondent, it was bound, under its contract of indemnity, and in good faith, *to sacrifice its interests in favor of those of the respondent*." 170 S.E. at 348 (emphasis in original). Referring to that case, the Fourth Circuit Court of

Appeals later held, "Of course, this does not mean that in every instance an insurer must accept an offer within policy limits, but it must act reasonably and in good faith." *Smith v. Maryland Cas. Co.*, 742 F.2d 167, 169 (4th Cir. 1984).

- In *Nichols v. State Farm Mutual Automobile Insurance Co.,* 279 S.C. 336, 306 S.E.2d 616 (1983), the South Carolina Supreme Court held that if an insured can demonstrate bad faith or unreasonable action by the insurer in processing a claim under the mutually binding insurance contract, he can recover consequential damages in a tort action. Actual damages are not limited by the contract. Further, if he can demonstrate the insurer's actions were willful or in reckless disregard of the insured's rights, he can recover punitive damages.

- All bad faith actions--including claims based on bad faith processing of the claims when there is no breach of the insurance contract--arise out of the implied warranty of good faith and fair dealing. *Ocean Winds Council of Co-Owners, Inc. v. Auto-Owners Ins. Co.*, 241 F.Supp.2d 572, 577 (D.S.C. 2002), citing *Tadlock Painting Co. v. Maryland Cas. Co.,* 322 S.C. 498, 473 S.E.2d 52 (1996).

- What are the applicable statutes of limitations?

  - Three years. S.C. Code Ann. § 15-3-530.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - If there is a reasonable ground for contesting a claim, there is no bad faith." *Crossley v. State Farm Mut. Auto. Ins. Co.,* 307 S.C. 354, 360, 415 S.E.2d 393, 397 (1992).

  - The South Carolina Supreme Court has ruled that a legitimate dispute over a novel legal issue is a reasonable basis to deny a claim as a matter of law. *Myers v. Government Employees Ins. Co.*, 279 S.C. 70, 73-74, 302 S.E.2d 331, 333 (1983). However, an insurer is not insulated from liability for bad faith merely because there is no clear precedent resolving a coverage issue raised under the particular facts of a case. *Mixson, Inc. v. American Loyalty Ins. Co.*, 349 S.C. 394, 562 S.E.2d 659 (Ct. App. 2002).

- An insured is not entitled to a judgment for bad faith against an insurer merely because the insured obtained judgment as a matter of law on the issue of coverage. *Strickland v. Prudential Ins. Co. of America*, 278 S.C. 82, 292 S.E.2d 301, 304 (1982)(affirming special referee's judgment as to the existence of coverage, but reversing the judgment as to bad faith).

- What are the recoverable damages for the bad faith cause of action?

  - Contract damages

  - Attorney fees. Attorney's fees are recoverable if the insurer fails to pay a covered claim and the trial judge finds the refusal to pay the policyholder's claim was without reasonable cause or in bad faith. S.C. Code § 38-59-40. This statute applies only to breach of contract causes of action, not to tort causes of action. *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 341, 306 S.E.2d 616, 620 (1983).

  - Consequential damages. *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 340, 306 S.E.2d 616, 619 (1983).

  - Punitive Damages. *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 340, 306 S.E.2d 616, 619 (1983).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. The insured must demonstrate the insurer's actions were willful or in reckless disregard of the insured's rights to recover punitive damages. *Nichols v. State Farm Mut. Auto. Ins. Co.*, 279 S.C. 336, 340, 306 S.E.2d 616, 619 (1983).

- Are punitive damages insurable?

  - Yes. *S.C. State Budget & Control Bd. v. Prince*, 304 S.C. 241, 403 S.E.2d 643 (1991).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - This issue has not been specifically addressed by South Carolina courts; however, in bad faith failure to settle cases, courts have found an insurer liable for the amount of an excess verdict without distinguishing between the compensatory damages and punitive damages awarded in the underlying case. *See Hodges v. State Farm Mut. Auto. Ins. Co.*, 488 F. Supp. 1057 (D.S.C. 1980).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - This issue has not been addressed by the South Carolina state appellate courts. The Federal District Court for the District of South Carolina rejected a per se disqualification rule giving an insured the right to retain independent counsel of its own choosing at the insurer's expense where only a potential for a conflict of interest exists because a reservation of rights notice has been given. The court found cases from other jurisdictions rejecting the per se rule to be better reasoned, more in line with South Carolina jurisprudence, and in accordance with traditionally accepted practices in South Carolina. *Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of South Carolina, LP*, 336 F.Supp.2d 610, 621 (D.S.C. 2004).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - This issue has not been addressed by South Carolina courts.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No.

SOUTH DAKOTA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. However, the following statutes set forth some standards for insurance carriers, but, as noted below, SDCL § 58-33-69 specifically states that the following standards do not create a private cause of action.

        - SDCL § 58-33-67 is the statute which identifies unfair trade practices of insurance companies. It provides as follows:

            In dealing with the insured or representative of the insured, unfair or deceptive acts or practices in the business of insurance include, but are not limited to, the following:

            (1) Failing to acknowledge and act within thirty days upon communications with respect to claims arising under insurance policies and to adopt and adhere to reasonable standards for the prompt investigation of such claims;

            (2) Making claims payments to any claimant, insured, or beneficiary not accompanied by a statement setting forth the coverage under which the payments are being made;

            (3) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement;

(4) Failing to promptly settle claims, where liability has become reasonably clear under one portion of the insurance policy coverage to influence settlements under other portions of the insurance policy coverage;

(5) Requiring as a condition of payment of a claim that repairs to any damaged vehicle shall be made by a particular contractor or repair shop;

(6) Failing to make a good faith assignment of the degree of contributory negligence in ascertaining the issue of liability;

(7) Unless permitted by law and the insurance policy, refusing to settle a claim of an insured or claimant on the basis that the responsibility should be assumed by others.

- Insureds often attempt to use the UTPA as the basis for a bad faith claim. However, SDCL § 58-33-69 specifically provides that the above referenced unfair trade practices may not be used to support a claim for bad faith. It provides as follows: "*Nothing in §§ 58-33-66 to 58-33-69, inclusive, grants a private right of action.*"

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Yes. "'[A]n insurer's violation of its duty of good faith and fair dealing constitutes a tort, even though it is also a breach of contract. Such tortious conduct is demonstrated where there is unreasonable delay in performing under a contract, including delays in settlement under a liability policy.'" *Champion v. United States Fidelity & Guaranty Co.*, 399 N.W.2d 320, 322 (S.D. 1987) (quoting 16A J.A. Appleman & J. Appleman, *Insurance Law and Practice* § 8878.15, at 422-24 (1981)).

  - Bad faith is an intentional tort and typically occurs when an insurance company consciously engages in wrongdoing during its processing or paying of policy benefits to its insured. *Hein v. Acuity*, 2007 S.D. 40, ¶ 10, 731 N.W.2d 231, 235 (2007).

- Insured must show an absence of a reasonable basis for denial of policy benefits [or failure to comply with a duty under the insurance contract] *and* the knowledge or reckless disregard [or the lack] of a reasonable basis for denial. *Phen v. Progressive Northern Ins. Co.,* 672 N.W.2d 52, 59 (S.D. 2003).

- The denial of a claim that is not fairly debatable is strong evidence of bad faith. *Bertelsen v. Allstate Ins. Co.*, 796 N.W.2d 685, 698 (S.D. 2011).

- See the discussion below, in the section on Third Party Bad Faith, regarding claims for bad faith failure to settle.

- What are the applicable statutes of limitations?

  - No South Dakota case addresses the applicable statute of limitations relative to a bad faith cause of action. However, SDCL § 15-2-13 provides for a 6 year statute of limitations for actions based on breach of contract or statute. SDCL § 15-2-14 provides for a 3 year statute of limitations for negligence and personal injury. *Morgan v. Baldwin,* 450 N.W.2d 783 (S.D. 1990), however, provides that when there are overlapping theories of recovery with different periods of limitation, the limitations issue is resolved in favor of the longer period. Therefore, since a bad faith action sounds both in tort and contract, the longer six year period may apply.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Fairly Debatable - The insurer is permitted to challenge claims which are fairly debatable. *Hein v. Acuity*, 2007 S.D. 40, ¶ 10, 731 N.W.2d 231, 235 (2007). The insurer is not guilty of a bad faith denial of a first party claim where the question whether a policy exclusion is void is fairly debatable. The insurer will be found liable for bad faith only where it has intentionally denied (or failed to process or pay) a claim without a reasonable basis. *Phen v. Progressive Northern Ins. Co.,* 672 N.W.2d 52, 2003 S.D. 133 (2003). Moreover, in first party claims "being dilatory or even slow …

doesn't in and of itself amount to bad faith." *Arp v. AON/Combined Ins. Co.*, 300 F.3d 913, 916 (8th Cir. 2002)

- Matter of First Impression – In *Mudlin v. Hills Materials Co.*, the South Dakota Supreme Court implied that an insurer in South Dakota is not liable for bad faith where the denial is based on an issue of first impression. 2007 S.D. 118, ¶ 14, 742 N.W.2d 49, 53-54 (2007).

- What are the recoverable damages for the bad faith cause of action?

  - Attorney's Fees – *See* SDCL 53-12-3, which states:

    In all actions or proceedings hereafter commenced against any employer who is self-insured, or insurance company, including any reciprocal or interinsurance exchange, on any policy or certificate of any type or kind of insurance, if it appears from the evidence that such company or exchange has refused to pay the full amount of such loss, and that such refusal is vexatious or without reasonable cause, the Department of Labor, the trial court and the appellate court, shall, if judgment or an award is rendered for plaintiff, allow the plaintiff a reasonable sum as an attorney's fee to be recovered and collected as a part of the costs, provided, however, that when a tender is made by such insurance company, exchange or self-insurer before the commencement of the action or proceeding in which judgment or an award is rendered and the amount recovered is not in excess of such tender, no such costs shall be allowed. The allowance of attorney fees hereunder shall not be construed to bar any other remedy, whether in tort or contract, that an insured may have against the same insurance company or self-insurer arising out of its refusal to pay such loss.

  - Consequential Damages - Insurer who is guilty of bad faith may be liable for entire judgment against its insured regardless of policy limits. *Kunkel v. United Sec. Ins. Co.*, 84 S.D. 116, 168 N.W.2d 723 (1969).

  - Emotional distress damages are recoverable if the plaintiff establishes that he suffered pecuniary loss which caused the emotional distress. *Kunkel v. United Sec. Ins. Co.*, 84 S.D. 116, 135, 168 N.W.2d 723, 734 (1969); *Athey v. Farmers Ins. Exch.*, 234 F.2d 357, 363 (8th Cir. 2000); *see In re Cert. of a Question of Law*, 399 N.W.2d

320, 322 (S.D. 1987) (*dicta* saying *Kunkel* recognized right of recovery).

- With respect to other torts, it has been held that recovery requires proof of the elements of either intentional infliction of emotional distress or sufficient physical symptoms to permit recovery for negligent infliction of emotional distress. *Maryott v. First Nat'l Bank,* 624 N.W.2d 96, 102-103 (S.D. 2001) (wrongful dishonor of checks resulting in destruction of Plaintiff's business clinical depression, shame and humiliation not compensable because no physical symptoms); *Karas v. American Family Ins. Co.,* 33 F.3d 995, 999-1000 (8th Cir. 1994) (misrepresentation of insurance coverage to be provided). *But cf. Roth v. Farner-Bocken Co.,* 2003 S.D. 651, 667 N.W.2d 651, 662 (2003) (sustaining emotional distress recovery for invasion of privacy resulting in sleeplessness and obtaining assistance from colleagues at Alcoholics Anonymous); *Kansas Bankers Ins. Co. v. Lynass,* 920 F.2d 546, 549 (8th Cir. 1990) (intentional infliction of emotional distress claim rejected but remanded for consideration of bad faith claim; unclear whether emotional distress damages might be sought for bad faith).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - SDCL § §21-3-2:

    In any action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, actual or presumed, … the jury, in addition to the actual damage, may give damages for the sake of example, and by way of punishing the defendant.

    - Malice sufficient to justify award of punitive damages may be inferred from challenged behavior, if it can be shown that liable party's actions were willful and wanton. *Kirchoff v. American Cas. Co.,* 997 F.2d 401, 406 (8th Cir. 1993); *Bertelsen v. Allstate Ins. Co.*, 796 N.W.2d 685, 698-99 (S.D. 2011).

  - *Athey v. Farmers Ins. Exch.,* 234 F.3d 357, 363 (8th Cir. 2000) (conditioning settlement of an underinsurance policy on the release of a bad faith claim is sufficient evidence upon which to award

punitive damages.) Malice is required and may be actual or presumed. Actual malice is a positive state of mind; presumed malice is disregard for the rights of others. *Harter v. Plains Ins. Co.*, 579 N.W.2d 625, 634, 1998 S.D. 59 (1998).

- However, punitive damages are not available in breach of contract claims based on an insurance policy. *Kirchoff v. American Cas. Co.*, 997 F.2d 401, 406 (8th Cir. 1993).

- NOTE: SDCL § 21-1-4.1. Discovery and trial of exemplary damage claims. "*In any claim alleging punitive or exemplary damages, before any discovery relating thereto may be commenced and before any such claim may be submitted to the finder of fact, the court shall find, after a hearing and based upon clear and convincing evidence, that there is a reasonable basis to believe that there has been willful, wanton or malicious conduct on the part of the party claimed against*."

- Are punitive damages insurable?

  - No. A policy which "promise[s] to pay *damages for bodily injury or property damage* for which the law holds [the insured] responsible because of a car accident involving a car [it] insure[s]," and defines "damages" as "the cost of compensating those who suffer bodily injury or property damage from a car accident," only covers compensatory damages. *Dairyland Ins. Co. v. Wyant*, 474 N.W.2d 514, 515 (S.D. 1991). The court based its decision on the policy language and expressly did not rule on whether public policy precludes coverage for punitive damages.

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

  - No case in South Dakota decides this issue.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - No.

- A reservation of rights is a notice to the insured that the insurer will defend the insured but that the insurer is not waiving any defenses it may have under the policy. By this method, insurers can provide the insured a defense to liability and reserve for later the question whether the policy provides coverage. As in most jurisdictions, acting under a "reservation of rights" is an established procedure in South Dakota. "An insurer is not estopped notwithstanding participation in defense of an action against insured to assert noncoverage if timely notice was given to the insured that it has not waived benefit of its defense under the policy." *Connolly v. Standard Cas. Co.*, 76 S.D. 95, 73 N.W.2d 119, 122 (1955). *See also* Appleman § 4692 at 297; *St. Paul Fire and Marine Ins. Co. v. Engelmann*, 2002 S.D. 8, ¶ 19, 639 N.W.2d 192, 201 (2002).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

  - No South Dakota case has decided this issue.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

  - No. See SDCL § 58-23-1.

  - A direct action by an injured third-party against the tortfeasor's insurance company is barred by South Dakota statute. *See* SDCL § 58-23-1; *Railsback v. Mid-Century Ins. Co.*, 2004 S.D. 64, 680 N.W.2d 652.

  - An ancillary claim for fraud by an injured third-party arising out of settlement negotiations with the insurance company is not prohibited by the general rule against direct actions. *Railsback v. Mid-Century Ins. Co.*, 2004 S.D. 64, 680 N.W.2d 652 (2004).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- Absent a contractual relationship with the insurance carrier, South Dakota does not provide a basis for an injured party's direct action against an insurance carrier. However, somewhat confusing to the issue, the South Dakota Supreme Court has used the term "third party bad faith" to mean bad faith claims of an insured against the insurance carrier for failure to settle. *Hein v. Acuity*, 2007 S.D. 40, ¶ 9, 731 N.W.2d 231, 235 (2007); *Bertelsen v. Allstate Ins. Co.*, 796 N.W.2d 685, 700 (S.D. 2011).

- Third-party bad faith is traditionally based on principles of negligence and arises when an insurer wrongfully refuses to settle a case brought against its insured by a third-party." *Hein v. Acuity*, 2007 SD 40, ¶ 9, 731 N.W.2d 231, 235 (2007).

- In the so called "failure to settle" cases, while no single satisfactory test has been formulated as to what constitutes good or bad faith. Courts uniformly hold that the insured's interests must be considered. The insured's interests must be given "equal consideration" with those of the insurer. *Kunkel v. United Sec. Ins. Co. of N. J.*, 84 S.D. 116, 122, 168 N.W.2d 723, 726 (1969). "Third-party bad faith exists when an insurer breaches its duty to give equal consideration to the interests of its insured when making a decision to settle a case." *Hein v. Acuity*, 2007 SD 40, ¶ 9, 731 N.W.2d 231, 235 (2007).

- Eight Factors Considered:

  1) the strength of the injured claimant's case on the issues of liability and damages; (2) attempts by the insurer to induce the insured to contribute to a settlement; (3) failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; (4) the insurer's rejection of advice of its own attorney or agent; (5) failure of the insurer to inform the insured of a compromise offer; (6) the amount of financial risk to which each party is exposed in the event of a refusal to settle; (7) the fault of the insured in inducing the insurer's rejection of the compromise offer by misleading it as to the facts; and (8) any other factors tending to establish or negate bad faith

on the part of the insurer. *Kunkel v. United Sec. Ins. Co. of N. J.*, 168 N.W.2d 723, 727 (S.D. 1969).

- Conduct which merely is a breach of contract is not a tort, but the contract may establish a relationship demanding the exercise of proper care and acts and omissions in performance may give rise to tort liability. *Kunkel v. United Sec. Ins. Co. of N. J.*, 168 N.W.2d 723, 733 (S.D. 1969).

- Unlike the intentional nature of first-party bad faith, bad faith in the third-party context is tantamount to negligence. *Kunkel v. United Sec. Ins. Co. of N. J.*, 168 N.W.2d 723, 726 (S.D. 1969).

- What are the applicable statutes of limitations?

  - No South Dakota case addresses the applicable statute of limitations relative to a bad faith cause of action. However, SDCL § 15-2-13 provides for a 6 year statute of limitations or actions based on contract or statute. SDCL § 15-2-14 provides for a 3 year statute of limitations for negligence and personal injury. *Morgan v. Baldwin*, 450 N.W.2d 783 (S.D. 1990), however, provides when there are overlapping theories of recovery with different periods of limitation, the limitations issue is resolved in favor of the longer period. Therefore, since a bad faith action sounds both in tort and contract, the longer six year period most likely applies.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Fairly Debatable - Liability will not attach where a third party claim is fairly debatable; however, this defense does not apply where insured's liability and permanent and serious nature of plaintiff's injuries are unchallenged, even if value of claim is subject to dispute. *American States Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 6 F.3d 549, 553 (8th Cir. 1993).

  - Consent of insured not a recognized defense. *See American States. v. State Farm Mut. Auto. Ins. Co.*, 6 F.3d 549, 551-52 (8th Cir. 1993).

- What are the recoverable damages for the bad faith cause of action?

- Judgment in Excess of Policy Limits – *See e.g. Kunkel v. United Sec. Ins. Co. of N. J.*, 168 N.W.2d 723 (S.D. 1969); *Helmbolt v. LeMars Mut. Ins. Co., Inc.*, 404 N.W.2d 55 (S.D. 1987).

- Mental Suffering - *See Champion v. United States Fidelity & Guaranty Co.*, 399 N.W.2d 320, 322 (S.D. 1987) (*dicta* saying *Kunkel* recognized right of recovery).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes, if Plaintiff proves willful and wanton conduct. See discussion above as to First Party Bad Faith.

TENNESSEE

SUMMARY:

- Can insureds sue for bad faith (i.e. first party bad faith)? Yes
- Can third parties sue for bad faith (i.e. third party bad faith)? No.

FIRST PARTY BAD FAITH

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.
    - Under Tennessee law, there are two potential sources for claims involving first party bad faith:
        - Bad Faith Refusal to Pay statute, T.C.A. 56-7-105
            - ***56-7-105. Additional liability upon insurers and bonding companies for bad-faith failure to pay promptly.***

              (a) *The insurance companies of this state, and foreign insurance companies and other persons or corporations doing an insurance or fidelity bonding business in this state, in all cases when a loss occurs and they refuse to pay the loss within sixty (60) days after a demand has been made by the holder of the policy or fidelity bond on which the loss occurred, shall be liable to pay the holder of the policy or fidelity bond, in addition to the loss and interest on the bond, a sum not exceeding twenty-five percent (25%) on the liability for the loss; provided, that it is made to appear to the court or jury trying the case that the refusal to pay the loss was not in good faith, and that the failure to pay inflicted additional expense, loss, or injury including attorney fees upon the holder of the policy or fidelity bond; and provided, further, that the additional liability, within the limit prescribed, shall, in the discretion of the court or jury trying the case, be measured by the additional expense, loss, and injury including attorney fees thus entailed.*

> ***(b)*** *In any action against an unauthorized foreign or alien insurer or bonding company upon a contract of insurance or fidelity bond issued or delivered in this state to a resident of this state or to a corporation authorized to do business in this state, if the insurer or bonding company has failed for thirty (30) days after demand prior to commencement of the action to make payment in accordance with the terms of the contract or fidelity bond, and it appears to the court that the refusal was vexatious and without reasonable cause, the court may allow to the plaintiff a reasonable attorney fee and include the fee in any judgment that may be rendered in the action. The fee shall not exceed twelve and one half percent (12.5%) of the amount that the court or jury finds the plaintiff is entitled to recover against the insurer or bonding company, but in no event shall the fee be less than twenty-five dollars ($25.00). Failure of an insurer or bonding company to defend the action shall be deemed prima facie evidence that its failure to make payment was vexatious and without reasonable cause.*

- Tennessee Unfair Trade Practices and Unfair Claims Settlement Act of 2009, T.C.A. 56-8-101, et. seq.

- The bad faith statute and Unfair Claims Settlement Act are complementary legislation that accomplish different purposes; however, there is no private right of action under the Unfair Claims Settlement Act as the Commissioner of Insurance has the sole enforcement authority. Effective in 2011, the Tennessee legislature passed legislation making the Tennessee Consumer Protection Act, and potential treble damages, inapplicable to bad faith failure to settle claims. As a result, Titles 50 and Title 56 currently provide the sole and exclusive statutory remedies and sanctions available for the alleged breach of, or alleged unfair or deceptive acts and practices in connection with, a contract of insurance. This legislation took away the judicially-created recovery established in the case of *Myint v. Allstate Ins. Co.*, 970 S.W.2d 920, 927 (Tenn.1998), allowing recovery under the Tennessee Consumer Protection Act for unfair or deceptive acts or practices in the handling of an insurance claim. The Tennessee Consumer Protection Act also brought potential recovery for attorney fees and treble damages.

- In the context of a claim for bad faith denial of insurance coverage under the Tennessee bad faith statute, a plaintiff must demonstrate: (1) that the insurance policy, by its terms, became due and payable; (2) that a formal demand for payment was made; (3) that the insured waited sixty days after making demand before filing suit; and (4) that the insurer's refusal to pay was not in good faith. *Williamson v. Aetna Life Ins. Co.*, 481 F. 3d 369 (6th Cir 2007) rehearing en banc denied, certiorari denied 552 U.S. 1042, 128 S. Ct. 671, 169 L. Ed. 2d 514.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No, Tennessee law does not recognize a general common law tort for bad faith by an insurer brought by an insured - the exclusive remedy for such conduct is statutory. *Cracker Barrel Old Country Store, Inc. v. Cincinnati Ins. Co.,*590 F. Supp. 2d (M.D. Tenn. 2008)

- What are the applicable statutes of limitations?

    - As a general matter in Tennessee, suits arising out of a contract action have a six year statute of limitations; however, policies of insurance issued in Tennessee typically include a clause which reduces the time within which litigation over coverage disputes must be filed. Tennessee courts hold that insurance policy provisions limiting the time of a suit to a year after the date of loss mean twelve months after the cause of action accrues. See, *e.g.*, *Das v. State Farm Fire and Casualty Company*, 713 S.W.2d 318, 322 (Tenn. App. 1986), perm. app. Denied and *Sharp v. Allstate Insurance Company*, 1992 WL 289660 (Tenn. Ct. App. 1992). The cause of action accrues upon the insurance carrier's absolute and unconditional denial of liability on the policy. See, e.g., *Dixon v. Thomas Jefferson Insurance Company*, 1989 WL 150720 (Tenn. App. 1989).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

- Under Tennessee law, to sustain a claim for an insurer's failure to pay in bad faith, an insured must demonstrate that there were no legitimate grounds for disagreement about the coverage of the insurance policy. *Fulton Bellows, LLC v. Federal Ins. Co.* 662 F. Supp. 2d 976 (E.D. Tenn. 2009).

- Under Tennessee statute, an award of bad faith is not proper when the insurance carrier's refusal to pay is premised upon legitimate and substantial legal grounds or when the payment demand is greater than the judgment ultimately recovered. *Tyber v. Great Central Ins. Co.*, 572 F.2d 562 (6th Cir. 1978).

- The burden to show bad faith is high. For example, although the statutory language set out above states only that the refusal must be shown not to have been in good faith, there is case authority holding that the bad faith statutory penalty should not be awarded unless the insurance company's conduct involves moral turpitude. *Moore v. New Amsterdam Casualty Ins. Co.*, 199 F.Supp. 1941 (E.D. Tenn. 1961).

- Under Tennessee law, an insurance company is entitled to rely upon the defense that there are substantial legal grounds that the policy does not afford coverage for an alleged loss. *Nelms v. Tennessee Farmers Mutual Ins. Co.*, 613 S.W.2d 481 (Tenn. Ct. App. 1978 cert, den).

- What are the recoverable damages for the bad faith cause of action?

  - The Bad Faith Penalty Statute states:

    - "*The insurance companies of this state, and foreign insurance companies and other persons or corporations doing an insurance or fidelity bonding business in this state, in all cases when a loss occurs and they refuse to pay the loss within sixty (60) days after a demand has been made by the holder of the policy or fidelity bond on which the loss occurred, shall be liable to pay the holder of the policy or fidelity bond,* ***in addition to the loss and interest on the bond, a sum not exceeding twenty-five percent (25%) on the liability for the loss****…. and provided, further, that the additional liability, within the limit prescribed, shall, in the*

discretion of the court or jury trying the case, be measured by the additional expense, loss, and injury including attorney fees thus entailed." T.C.A. 56-7-105.

- Tennessee statute, stating that liability of an insurer is limited in all cases for refusal to pay claim to loss and interest thereon plus sum not exceeding 25% on the loss, provides the exclusive remedy for additional liability for refusal to pay insurance claim. T.C.A. § 56-7-105. *Rice v. Van Wagoner Companies, Inc.,* 738 F. Supp. 252 (M.D. Tenn. *1990).*

- An insured is entitled to damages, including award of attorney fees, where the record shows they were required to employ an attorney to file suit to recover benefits they were entitled to under fire policy. *Norris v. Nationwide Mut. Fire Ins. Co.,* 728 S.W. 2d 335 (Tenn. App. 1986).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Under prior law, *Myint v. Allstate Ins. Co.*, 970 S.W.2d 920, 927 (Tenn.1998), which allowed recovery against an insurance carrier pursuant to the Tennessee Consumer Protection Act, treble damages were recoverable but punitive damages were otherwise not recoverable. *Paty v. Herb Adcox Chevrolet Co.,* 756 S.W. 2d 697 (Tenn. App. 1988). Since 2011, the Tennessee Consumer Protection Act is no longer available as a recovery against insurance carriers.

- Are punitive damages insurable?

  - Under Tennessee law, directly assessed punitive damages are insurable in Tennessee unless they arose from intentional conduct. *Lazenby v. Universal Underwriters Ins. Co.*, 383 S.W.2d 1 (Tenn. 1964). The Tennessee Supreme Court has also held that in the absence of an insurance provision to the contrary, an insurer must satisfy a compensatory damage award, to the extent of its limits, before paying any part of a punitive damage award. *West v. Pratt*, 871 S.W.2d 477 (Tenn. 1994).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - The Tennessee Bad Faith Penalty Statute provides that "*the additional liability, within the limit prescribed, shall, in the discretion of the court or jury trying the case, be measured by the additional expense, loss, and injury including attorney fees thus entailed.*" T.C.A. 56-7-105. See also *Rice v Van Wagoner*, 738 F. Supp. 252 (M.D. Tenn. 1990).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - There is no case directly on point addressing this issue. Currently, *Cumis* is not the law. Under Tennessee law, the insured is the sole client of an attorney hired by a liability insurer pursuant to its contractual duty to defend. *Givens v. Mullikin ex. rel. Estate of McElwaney*, 75 S.W. 3d 383 (Tenn. 2002).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - An insurer cannot be liable under Tennessee law for the actions of its attorney based merely upon the existence of the employment relationship alone; some exercise of actual control, whether it be through direction or knowing authorization, must be involved. *Givens v. Mullikin ex. rel. Estate of McElwaney*, 75 S.W. 3d 383 (Tenn 2002). See also *Trau-Med of America, Inc. v. Allstate Ins. Co.*, 71 S.W.3d 691, 698 (Tenn. 2002).

THIRD PARTY BAD FAITH

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. Tennessee law generally holds that a claim of an insured against an insurer for alleged bad faith and negligence in refusing to settle within policy limits is not assignable by the insured to his

judgment creditor. See *Dillingham v. Tri-Star Insurance*, 381 S.W. 2d 94 (Tenn. 1963).

- However, an insured may assign an insurance policy *after* a loss has occurred, despite an anti-assignment clause purportedly prohibiting assignments without the consent of the insurer. *Manley v. Automobile Ins. of Hartford, Connecticut,* 169 S.W. 3d 207 (Tenn. App. 2005).

- Tennessee law also permits an excess insurer to sue a primary insurer for bad faith failure to settle a claim within policy limits after the excess carrier pays the excess portion of the judgment under the theory of equitable subrogation. *Great American Insurance Co. of New York v. Federal Ins. Co.,* 2010 WL 1712947 (Tenn. App. 2010); *Electric Insurance Company v. Nationwide Mutual Insurance Company*, 384 F. Supp. 2d 1190 (W.D. Tenn. 2005).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - No, see above.

TEXAS

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes, except an injured employee may not assert a first party common-law or statutory claim for breach of the duty of good faith and fair dealing against a workers' compensation carrier. *Texas Mut. Ins. Co. v. Ruttiger*, --- S.W.3d ----, 2012 WL 2361697 at *1 (Tex. 2012).

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Texas has created a statutory cause of action for bad faith based in the TEXAS DECEPTIVE TRADE PRACTICES-CONSUMER PROTECTION ACT ("DTPA"), TEX BUS. & COM. CODE § 17.41 et seq., a statute which expressly allows private claims against insurers as a means of consumer protection.

        - The elements of a DTPA action are: (1) the plaintiff is a consumer, (2) the defendant engaged in false, misleading, or deceptive acts, and (3) these acts constituted a producing cause of the consumer's damages. *Doe v. Boys Clubs of Greater Dallas, Inc.*, 907 S.W.2d 472, 478 (Tex. 1995); TEX. BUS. & COM. CODE § 17.50(a)(1) (2002).

        - First, a plaintiff must be a "consumer" as defined by the statute. TEX. BUS. & COM. CODE §17.50.

            - To qualify as a consumer, a plaintiff must be an individual, partnership, corporation, this state, or a subdivision or agency of this state who seeks or acquires by purchase or lease, any goods or services;

those goods or services must form the basis of the plaintiff's complaint. TEX. BUS. & COM. CODE §17.45(4).

- Consumer status under the DTPA is dependent upon showing the plaintiff's relationship to the transaction entitles him to relief. Whether a plaintiff qualifies for such status is a question of law when the facts underlying the determination of consumer status are undisputed.*See Ortiz v. Collins*, 203 S.W.3d 414, 424-25 (Tex. App.—Houston [14th Dist.] 2006, no pet.).

- In addition to establishing consumer status, a DTPA plaintiff must show a "false, misleading, or deceptive act," breach of warranty, unconscionable action or course of action by any person, or the use or employment by any person of an act or practice in violation of Chapter 541 of the TEXAS INSURANCE CODE; and that such conduct was the producing cause of the plaintiff's damage. TEX. BUS. & COM. CODE § 17.50(a)(1)-(4).

  - DTPA section 17.46(b) contains, in twenty-seven subparts, a nonexclusive list of actions which constitute "false, misleading or deceptive acts" under the statute. TEX. BUS. & COM. CODE § 17.46(b).

  - Section 17.45(5) of the DTPA defines an "unconscionable action or course of action" as "an act or practice which, to a consumer's detriment, takes advantage of the lack of knowledge, ability, experience, or capacity of the consumer to a grossly unfair degree." TEX. BUS. & COM. CODE § 17.45(5).

- Damages under DTPA

  - A prevailing plaintiff in a DTPA action may recover economic damages. TEX. BUS. & COM. CODE §17.50(b)(1).

  - In cases involving misrepresentation, the plaintiff may recover under either the "out of pocket" or "benefit of the bargain" measure of damages,

whichever gives the plaintiff a greater recovery. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997).

- If the trier of fact finds the defendant acted "knowingly," the plaintiff also may recover damages for mental anguish and additional statutory damages up to three times the amount of economic damages. TEX. BUS. & COM. CODE §17.50(b)(1).

- The availability of statutory remedies for breach of the duty of good faith and fair dealing was affirmatively recognized by the Texas Supreme Court in *Vail v. Tex. Farm Bureau Mut. Ins. Co.*, 754 S.W.2d 129, 131 (Tex. 1988).

- Furthermore, Texas has created a private cause of action under the TEXAS INSURANCE CODE for bad faith.

  - TEXAS INSURANCE CODE § 541.151 states:

    A person who sustains actual damages may bring an action against another person for those damages caused by the other person engaging in an act or practice:
    (1) defined by Subchapter B to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance; or
    (2) specifically enumerated in Section 17.46(b), Business & Commerce Code, as an unlawful deceptive trade practice if the person bringing the action shows that the person relied on the act or practice to the person's detriment

- Because the current provisions of the Texas Workers Compensation Act indicate legislative intent that its provisions for dispute resolution and remedies for failing to comply with those provisions in the workers' compensation context are exclusive, an injured employee may not assert a common-law or statutory claim for breach of the duty of good faith and fair dealing against a workers' compensation carrier regarding the settlement of that claim. *Texas Mut. Ins. Co. v. Ruttiger*, --- S.W.3d ----, 2012 WL 2361697 at *1 (Tex. 2012).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Tort = YES, Contract = NO

        - In *Arnold v. Nat'l County Mut Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987), the court first applied the tort theory to the insurance context and held there is a duty on the part of insurers to deal fairly and in good faith with their insureds.

        - Texas follows *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973) in allowing a BROAD first-party bad faith claim. *See Universe Life Ins. v. Giles*, 950 S.W.2d 48, 59 (Tex. 1997).

        - An insurer breaches its duty of good faith and fair dealing by denying or delaying a claim when the insurer's liability has become reasonably clear. *State Farm Fire & Cas. Co. v. Simmons*, 963 S.W.2d 42, 44 (Tex. 1998).

        - The focus is not on whether an insured's claim was valid, but on the reasonableness of the insurer's conduct in rejecting the claim. *Lyons v. Millers Cas. Ins. Co.*, 866 S.W.2d 597, 601 (Tex. 1993).

        - Evidence of coverage, standing alone, will not constitute evidence of bad faith denial. *Provident Am. Ins. Co. v. Castaneda*, 988 S.W.2d 189, 194 (Tex. 1998).

        - Evidence showing only a bona fide coverage dispute does not rise to the level of bad faith. *Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. Dominguez*, 873 S.W.2d 373, 376 (Tex. 1994).

        - Bad faith is not established when a trier of fact, using hindsight, decides the insurer was simply wrong about the proper construction of the terms of the policy. *Lyons v. Millers Cas. Ins. Co.*, 866 S.W.2d 597, 601 (Tex. 1993).

- As long as an insurer has a reasonable basis to deny payment of a claim, even if that basis is eventually determined to be erroneous, the insurer is not liable for the tort of bad faith. *Lyons v. Millers Cas. Ins. Co.*, 866 S.W.2d 597, 600 (Tex. 1993).

- In the context of a suit against the insured by a third party, Texas law recognizes only one tort duty of insurers, which is the duty under the *Stowers* doctrine to exercise ordinary care in the settlement of claims to protect their insureds against judgments in excess of policy limits. *Phillips v. Bramlett*, 288 S.W.3d 876, 879 (Tex.2009); *Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App.1929, holding approved). For the duty to settle to arise, there must be coverage for the third-party's claim, a settlement demand within policy limits, and reasonable terms "such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment." *Phillips v. Bramlett*, 288 S.W.3d 876, 879 (Tex.2009).

  When these conditions coincide and the insurer's negligent failure to settle results in an excess judgment against the insured, the insurer is liable under the *Stowers* Doctrine for the entire amount of the judgment, including that part exceeding the insured's policy limits. *Id.* This liability would include actual and punitive damages.

  However, a demand above policy limits, even though reasonable, does not trigger the duty to settle. *AFTCO Enters., Inc. v. Acceptance Indem. Ins. Co.*, 321 S.W.3d 65, 69 (Tex.App.-Houston [1st Dist.] 2010, pet. denied).

- There are different standards of causation for statutory and common law bad faith.

  - Producing cause is the causation standard for statutory bad faith claims under the DTPA and under Chapter 541 of the Texas Insurance Code. TEX. BUS. & COM. CODE § 17.50(a). "Producing cause" and "cause in fact" are conceptually identical. *Transcon .Ins.*

Co. v. Crump, 330 S.W.3d 211, 223 (Tex. 2010). Producing cause" is defined as "a substantial factor in bringing about an injury, and without which the injury would not have occurred." *Transcon..Ins. Co. v. Crump*, 330 S.W.3d 211, 223 (Tex. 2010).

- Proximate cause is the causation standard for common law claims of breach of the duty of good faith and fair dealing. *Provident Am. Ins. Co. v. Castaneda*, 988 S.W.2d 189, 193 n. 13 (Tex. 1998). The components of proximate cause are cause in fact and foreseeability. *Doe v. Boys Clubs of Greater Dallas, Inc*., 907 S.W.2d 472, 477 (Tex. 1995).

- What are the applicable statutes of limitations?

  - In Texas, there is a two-year limitations period for torts. TEX. CIV. PRAC. & REM. CODE § 16.003 (2002). The statute of limitations begins to run at the time an insurance company denies a claim, not the date a separate suit to determine coverage under the contract is resolved. *Murray v. San Jacinto Agency, Inc*., 800 S.W.2d 826, 829 (Tex. 1990).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - Defenses →*see generally* Stephen G. Cochran, *Duty of good faith and fair dealing – Defenses*, 27 Tex. Prac., Consumer Rights and Remedies § 5.15 (3d ed.) (2009).

  - "Genuine dispute of fact" defense is available since Texas follows *Gruenberg*.

  - Where the court finds the damage sustained by the insured was in fact not covered by the policy, a cause of action for failure to investigate and process the claim in good faith is precluded. *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338, 341 (Tex. 1995).

  - In most circumstances, the insured may not prevail on bad faith claim without first showing that insurer breached the insurance contract. *Liberty Nat. Fire Ins. Co. v. Akin*, 927 S.W.2d 627, 629 (Tex. 1996)

- If the insurance company has a reasonable basis for its denial or delay, it will have a defense.

    - A "reasonable basis" is to be judged by the facts available to the insurance company at the time the claim was denied. *Viles v. Sec. Nat'l Ins. Co.*, 788 S.W.2d 566, 567 (Tex. 1990).

    - Proof of some evidence of unreasonableness on the part of the insurance company is not sufficient to establish the cause of action. The insured must show there was no reasonable basis for denying the claim. *State Farm Lloyds, Inc. v. Polasek*, 847 S.W.2d 279, 285-88 (Tex. App.—San Antonio 1992, writ denied).

- A defense based upon a "bona fide dispute" or controversy as to the insurance company's liability on the policy is available.

    - Evidence which merely shows a bona fide dispute about the insurer's liability on the contract does not rise to the level of bad faith.

- The issue of collateral estoppel has been raised as a defense in the context of workers' compensation cases where releases executed by the claimant, as part of the settlement of the case, stated the agreement was the result of a "bona fide disputed claim" and the carrier's liability was "uncertain, indefinite and incapable of being satisfactorily established."

- What are the recoverable damages for the common law bad faith cause of action?

    - A bad-faith insurance case potentially can result in three types of damages. *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 17 (Tex. 1994).

        - Benefit of the bargain damages for an accompanying breach of contract claim.

        - Compensatory damages for the tort of bad faith.

- Texas limits mental anguish damages in bad faith cases "to those cases in which the denial or delay in payment of a claim has seriously disrupted the insured's life." *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 54 (Tex. 1997).

    - Punitive damages for intentional, malicious, fraudulent, or grossly negligent conduct.

- Also, prejudgment interest on an award of damages for breach of the duty to defend will be assessed against an insurer based on the dates the insured's paid each bill for attorney's fees, rather than the date the insurer refused to defend. *Primrose Operating Co. v. Nat'l Am. Ins. Co.*, 382 F.3d 546, 566 (5th Cir. 2004) (applying Texas law).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Yes. In order to recover punitive damages, actual damages separate and apart from the wrongfully withheld insurance benefits must be proven. *Twin City Fire Ins. Co. v. Davis*, 904 S.W.2d 663, 665 (Tex. 1995).

        - Additionally, this court held a breach of contract alone will not support punitive damages; the existence of an independent tort must be established. The independent tort must be accompanied by a finding of actual damages.

- Are punitive damages insurable?

    - Maybe. Determining whether exemplary or punitive damages for gross negligence are insurable requires a two-step analysis. *Fairfield Ins. Co. v. Stephens Martin Paving, L.P.*, 246 S.W.3d 653, 655 (Tex.2008). First, the court decides whether the plain language of the policy covers the exemplary damages sought in the underlying suit against the insured.

    - Second, if the court concludes that the policy provides coverage, the court determines whether the public policy of Texas allows or prohibits coverage in the circumstances of the underlying suit. To

make that determination, the court first looks to express statutory provisions regarding the insurability of exemplary damages to determine whether the Legislature has made a policy decision. *Fairfield Ins. Co. v. Stephens Martin Paving, L.P.*, 246 S.W.3d 653, 655 (Tex.2008). If the Legislature has not made an explicit policy decision, the court then considers whether the general public policies of Texas allow or prohibit coverage in the circumstances of the underlying suit. *Id.*

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Yes. Texas law recognizes only one tort duty of insurers in cases involving suits by third-parties against the insured, which is the duty under the *Stowers* doctrine to exercise ordinary care in the settlement of claims to protect their insureds against judgments in excess of policy limits. *Phillips v. Bramlett*, 288 S.W.3d 876, 879 (Tex.2009); *Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm'n App.1929, holding approved). For the duty to settle to arise, there must be coverage for the third-party's claim, a settlement demand within policy limits, and reasonable terms "such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment." *Phillips v. Bramlett*, 288 S.W.3d 876, 879 (Tex.2009).
      When these conditions coincide and the insurer's negligent failure to settle results in an excess judgment against the insured, the insurer is liable under the *Stowers* Doctrine for the entire amount of the judgment, including that part exceeding the insured's policy limits. *Id.* This liability would include actual and punitive damages.

      However, a demand above policy limits, even though reasonable, does not trigger the duty to settle. *AFTCO Enters., Inc. v. Acceptance Indem. Ins. Co.*, 321 S.W.3d 65, 69 (Tex.App.-Houston [1st Dist.] 2010, pet. denied).

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

- No. Neither any Texas statute nor any case follows the *Cumis* case to require that the insurer allow the insured to appoint defense counsel when the insurer and insured have a conflict of interest.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No. An insurer is not vicariously liable for the malpractice of an independent attorney it selects to defend an insured. *State Farm Mutual Automobile Insurance Co. v. Traver*, 980 S.W.2d 625, 626–29 (Tex. 1998).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action by a third party? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. In Texas, a third-party cannot bring a direct action under the DTPA or Insurance Code. *Allstate Ins. Co. v. Watson*, 876 S.W.2d 145 (1994) (ruling later codified).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith) by a third party? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. In Texas, a third-party cannot bring a direct bad faith claim against an insurer by tort or statute for the insurer's handling of the third party's claim. *Transport Insurance Company v. Faircloth*, 898 S.W.2d 269 (Tex. 1995)(no common law bad faith claim by third party).

UTAH

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes, in contract when a first party policy is involved, and in tort when a third party liability policy is involved.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Utah has expanded the damages available under a traditional breach of contract claim. Under Utah law, parties to an insurance contract have mutual duties to execute the contract in good faith and with fair dealing. This duty was generally applied only to the first party contractual relationship. *Sperry v. Sperry*, 990 P.2d 381 (Utah1999); *see* also *Savage v. Educators Ins. Co.,* 908 P.2d 862, 866 (Utah 1995); *see also Ammerman v. Farmers Ins. Exch.,* 19 Utah 2d 261, 430 P.2d 576, 577-78 (1967) (explaining that duty of good faith is owed to first parties to insurance contract, not third-party beneficiaries); *Pixton v. State Farm Mut. Auto. Ins. Co.,* 809 P.2d 746, 749 (Utah Ct.App.1991) ("[T]here is no duty of good faith and fair dealing imposed upon an insurer running to a third-party claimant ... seeking to recover against the company's insured."); *cf. Beck v. Farmers Ins. Exch.,* 701 P.2d 795, 801 (Utah 1985) (defining duty of good faith insurer owes to insured).

- In *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 800 (Utah 1985), the Court reasoned that a breach of the duty of good faith in the first-party context gives rise to a claim that is more properly stated in contract than in tort. The Utah Supreme Court declined to extend the tort cause of action for bad faith to first-party cases, holding instead "that the good faith duty to bargain or settle under an insurance contract is only one aspect of the duty of good faith and fair dealing implied in all contracts and that a violation of that duty gives rise to a claim for breach of contract."

- In rejecting a tort approach, the court did not ignore what it identified as "the principal reason for the adoption of the tort approach--to provide damage exposure in excess of the policy limits and thus remove any incentive for breaching the duty of good faith." The court achieved that goal by applying the rule of *Hadley v. Baxendale* --that the victim of a contract breach may recover compensation only for harm "arising naturally, i.e., according to the usual course of things, from such breach of contract itself" or harm 'in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it"--in a moderate and reasoned manner, rejecting the inflexible rule that the damages recoverable for breach of an insurance policy are limited to the amount specified in the policy. The court noted a broad range of recoverable damages is conceivable, particularly given the unique nature and purpose of an insurance contract. An insured frequently faces catastrophic consequences if funds are not available within a reasonable period of time to cover an insured loss; damages for losses well in excess of the policy limits, such as for a home or a business, may therefore be foreseeable and provable. Furthermore, it is axiomatic that insurance frequently is purchased not only to provide funds in case of loss, but to provide peace of mind for the insured or his beneficiaries. Therefore, although other courts adopting the contract approach have been reluctant to allow such an award, we find no difficulty with the proposition that, in unusual cases, damages for mental anguish might be provable.

- However, in *Prince v. Bear River Mut. Ins. Co.*, 56 P.3d 524 (Utah 2002), the court noted that an insurer has a right deny a claim, "[i]f the evidence presented creates a factual issue as to the claim's

validity, there exists a debatable reason for denial, . . . eliminating the bad faith claim." *Callioux v. Progressive Ins. Co.*, 745 P.2d 838, 842 (Utah Ct.App.1987); *see also* 14 Lee R. Russ & Thomas F. Segalla, *Couch on Insurance* 3d § 204:28 (1999) ("A 'debatable reason,' for purposes of determining whether a first-party insurer may be subjected to bad-faith liability, means an arguable reason, a reason that is open to dispute or question."). In *Prince* the court found a medical opinion that challenged the plaintiff's claims, even though the defendant had retained and paid the physician for his opinion, was a valid and reasonable basis upon which the defendant could deny the claim without bad-faith liability.

If an insurer acts reasonably in denying a claim, then the insurer did not contravene the covenant. The denial of a claim is reasonable if the insured's claim is fairly debatable. Under Utah law, if an insurer denies an " 'insured's claim [that] is fairly debatable, the insurer is entitled to debate it and cannot be held to have breached the implied covenant if it chooses to do so.' "

- "[A]n insurer owes its insured a duty to accept an offer of settlement within the policy limits when there is a substantial likelihood of a judgment being rendered against the insured in excess of those limits. [Citation omitted.] The test of the insurer's conduct is one of reasonableness." *Campbell v. State Farm Mut. Auto. Ins. Co.*, 840 P.2d 130, 138 (Utah Ct. App. 1992). In this third party liability policy context, the cause of action may be stated in tort. *Id.* See also, *Beck v. Farmers Ins. Exchange*, 701 P.2d 795, 799-800 (Utah 1985).

- What are the applicable statutes of limitations?

  - Three-year statute of limitations is applicable to an action on a written policy or contract of first-party insurance, rather than the four-year statute of limitations for relief not otherwise provided for by law. U.C.A.1953, 31A-21-313, 78-12- 25(3). *Tucker v. State Farm Mut. Auto. Ins. Co.*, 53 P.3d 947, Utah (2002)

    § 31A-21-313. Limitation of actions

(1) An action on a written policy or contract of first party insurance must be commenced within three years after the inception of the loss.

(2) Except as provided in Subsection (1) or elsewhere in this title, the law applicable to limitation of actions in Title 78, Chapter 12, Limitation of Actions, applies to actions on insurance policies.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - An insurer is entitled to challenge its obligations under an insurance contract as long as such claim is "fairly debatable." *Prince v. Bear River Mut. Ins. Co.*, 56 P.3d 524 (Utah 2002). Moreover, "[w]hen a claim is fairly debatable, the insurer is entitled to debate it, whether the debate concerns a matter of fact or law." *Callioux v. Progressive Ins. Co.*, 745 P.2d 838, 842 (Utah Ct.App.1987) (quoting *McLaughlin v. Alabama Farm Bureau Mut. Casualty Ins. Co.*, 437 So.2d 86, 90 (Ala.1983)). The reason for such rule is plain: It would not comport with our ideas of either law or justice to prevent any party who entertains bona fide questions about his legal obligations from seeking adjudication thereon in the courts. *Id.*

    - Comparative Negligence – Liability Reform Act provides: "[T]he maximum amount for which a defendant may be liable to any person seeking recovery is that percentage or proportion of the damages equivalent to the percentage or proportion of fault attributed to that defendant." Utah Code Ann. § 78-27-40 (1992).

- What are the recoverable damages for the bad faith cause of action?

    - The insured's exposure to an excess judgment is not the only legally cognizable damage to which an insured might be entitled. Rather, the amount of the excess judgment itself, as well as damages for injury to reputation or credit rating, damages for emotional distress, and punitive damages are all potentially recoverable by an insured. *Campbell v. State Farm Mut. Auto Ins. Co.*, 840 P.2d 130, 139 (1992).

- The Court in *Beck* declared that, even in a first-party case, it had "no difficulty with the proposition that, in unusual cases, damages for mental anguish might be provable." *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 802 (Utah 1985). The Court reasoned that such consequential damages might be foreseeable and provable because it is "axiomatic that insurance frequently is purchased not only to provide funds in case of loss, but to provide peace of mind for the insured or his beneficiaries." *Id.*

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes.

  - In *Campbell v. State Farm Mut. Auto. Ins. Co.*, the insured brought an action against his automobile liability insurer to recover for bad-faith failure to settle within the policy limits, fraud, and intentional infliction of emotional distress. Following remand from the Utah Court of Appeals (see 840 P.2d 130, 139 (1992)), the Third District Court, Salt Lake County, entered judgment on jury verdict in favor of the insured, but remitted punitive and compensatory damages. The Supreme Court of Utah, 65 P.3d 1134, reinstated the jury's punitive damage award. Certiorari was granted. The United States Supreme Court, 538 U.S. 408, 123 S.Ct. 1513, 155 L.Ed.2d 585, reversed and remanded. The U.S. Supreme Court held that the Due Process Clause prohibits the imposition of grossly excessive or arbitrary punishment; it furthers no legitimate purpose and constitutes arbitrary deprivation of property. In *Campbell* the Supreme Court found the defendant was being punished for conduct in other jurisdictions where it was lawful. The Court found this was improper.

    On remand, following the opinion of the Supreme Court, the Utah Supreme Court, held that: (1) the insurer's conduct warranted punitive damages of nine times the compensatory and special damages; and (2) costs and attorney fees are not part of the compensatory award in calculating the 9x ratio between punitive and compensatory damages. *Campbell v. State Farm Mut. Auto. Ins. Co.*, 98 P.3d 409 (Utah 2004).

- Are punitive damages insurable?

    - No Utah case has decided this issue. However, in *Biswell v. Duncan*, 742 P.2d 80, 85 (Utah Ct. App. 1987), the court held punitive damages could be awarded in drunken driving accident cases, noting that such damages may be an effective deterant since they are "usually paid by the defendant personally and not by insurance." (Citing *Northwestern Nat. Cas. Co. v. McNulty*, 307 F.2d 432 (5th Cir.1962)).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - No case in Utah has decided this specific issue. However, in *Campbell v. State Farm Mut. Auto. Ins. Co.*, 840 P.2d 130, 140 (Utah Ct. App. 1992), the court held that paying the excess judgment is not the only possible consequence of failing to settle within limits. "Eventual payment of the excess judgment does not compensate the insured for emotional injury, damages to the insured's reputation and credit rating, *any punitive damages awarded against the insured*, or any other legally cognizable injury stemming from the insurer's failure to settle. Nor does it 'cure' the insurer's earlier wrongful conduct." Including punitive damages awarded against the insured as a "legally congnizable injury" from the failure to settle implies that they would be recoverable.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - No case in Utah has decided this specific issue.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - In the third-party context, an insured may state a cause of action in tort for an insurer's breach of its obligations. *Beck v. Farmers Ins. Exch.,* 701 P.2d 795, 799 (Utah 1985). However, non-insureds may not sue the insurer. S*ee Ammerman v. Farmers Ins. Exch.,* 19 Utah 2d 261, 430 P.2d 576, 577-78 (1967) (explaining that duty of good faith is owed to first parties to insurance contract, not third-party beneficiaries); *Pixton v. State Farm Mut. Auto. Ins. Co.,* 809 P.2d 746, 749 (Utah Ct.App.1991) ("[T]here is no duty of good faith and fair dealing imposed upon an insurer running to a third-party claimant . . . seeking to recover against the company's insured.").

VERMONT

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. The Vermont Supreme Court ruled Vermont's Insurance Trade Practices Act (Vt. Stat. Ann. tit. 8 § 4721) does not create a private cause of action. *Wilder v. Aetna Life & Cas. Ins. Co.*, 433 A.2d 309 (Vt. 1981). The *Wilder* Court also held Vermont's Consumer Fraud Act did not cover the sale of insurance because "the selling of an insurance contract is not a "contract for 'goods or services' within the meaning of that [Act]."

    - Vt. Stat. Ann. tit. 8 § 4717 sets out unfair methods of competition and unfair or deceptive acts, however it does not create a private right of action.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. Vermont recognizes a cause of action for bad faith for failure to pay a first-party claim by its insured. *Bushey v. Allstate Ins. Co.*, 670 A.2d 807 (Vt. 1995).

    - To establish a tort of bad faith, a first party claimant must prove:

        (1) That the insurance company had no reasonable basis to deny the benefits of the policy, and,
        (2) That the insurance company knew or recklessly disregarded the fact that no reasonable basis existed for

denying the claim. *Bushey v. Allstate Ins. Co.*, 670 A.2d 807, 809 (Vt. 1995).

- Vermont also recognizes a cause of action for bad faith in the context of handling third-party claims against an insured. *Myers v. Ambassador Ins. Co., Inc.*, 508 A.2d 689, (Vt. 1986). "The insurer's fiduciary duty to act in good faith when handling a claim against the insured obligates it to take the insured's interests into account. The company must diligently investigate the facts and the risks involved in the claim, and should rely only upon persons reasonably qualified to make such an assessment. If demand for settlement is made, the insurer must honestly assess its validity based on a determination of the risks involved. In addition, and more pertinent to this case, the insurer must fully inform the insured of the results of its assessment of the risks, including any potential excess liability, and convey any demands for settlement which have been made." *Id.* (Citations and footnote omitted).

- What are the applicable statutes of limitations?

  - 12 V.S.A. § 511. *A civil action, except one brought upon the judgment or decree of a court of record of the United States or of this or some other state, and except as otherwise provided, shall be commenced within six years after the cause of action accrues and not thereafter.*

  - The Vermont Supreme Court has given an indication that this general six year statute of limitations would apply to an action for bad faith. *Benson v. MVP Health Plan, Inc.*, 978 A.2d 33 (Vt. 2009); *see also Kauffman v. State Farm Mut. Auto. Ins. Co., 857 F. Supp. 23 (D. Vt. 1994) (*holding the six year statute of limitations governs actions arising from breach of an insurance contract).

  - The three year statutory period may apply to injuries for emotional-distress as part of a bad faith claim, as a bodily injury within 12 V.S.A. § 512. *See Fitzgerald v. Congleton*, 583 A.2d 595 (Vt. 1990) (indicating the nature of the harm sustained determines which statute of limitations applies).

  - "A cause of action against an insurance company for bad faith accrues when the company errs, unreasonably, in denying

coverage." *Benson v. MVP Health Plan, Inc.*, 978 A.2d 33, 35 (Vt. 2009) (citation omitted).

- An insurer can limit the time period in which an insured can bring a claim for bad faith but it must be at least twelve months from the date of the occurrence of the loss, death, accident or default. *Gilman v. Maine Mut. Fire Ins. Co.*, 830 A.2d 71, 75 (Vt. 2003) ("Policy provisions establishing limitation periods by contract are valid and enforceable against an insured if the limitation period is not less than 'twelve months from the occurrence of the loss, death, accident or default.'" (Quoting 8 V.S.A. § 3663)).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - An insurer that has a reasonable basis to deny an insured's claim is not liable for bad faith. *Bushey v. Allstate Ins. Co.*, 670 A.2d 807 (Vt. 1995). Instead, it is only liable for bad faith where the plaintiff establishes: "(1) the insurance company had no reasonable basis to deny benefits of the policy, and (2) the company knew or recklessly disregarded the fact that no reasonable basis existed for denying the claim." *Id.* (Citing *Booska v. Hubbard Ins. Agency, Inc.*, 627 A.2d 333 (Vt. 1993)).

  - An insurer may have a defense if a claim is debatable. The insurer will only be liable if it denied the claim without a reasonable basis. *Davis v. Liberty Mut. Ins. Co.*, 1998, 19 F.Supp.2d 193, *affirmed* 267 F.3d 124.

  - The advice of counsel defense may be available in bad faith cases because it is generally recognized in Vermont. *See Wash. Elec. Coop., Inc. v. Mass. Mun. Wholesale Elec. Co.*, 894 F. Supp. 777 (D. Vt. 1995).

  - If the court ultimately finds a loss was not covered under an insurance policy then there is no action for bad faith. *Serecky v. Nat'l Grange Mut. Ins.*, 857 A.2d 775, 785 (Vt. 2004) ("We concluded above that defendants' policies do not cover the acts alleged in plaintiffs' underlying complaint. Thus, as a matter of law, defendants did not act in bad faith in denying coverage.")

- An insurer can assert an insured's failure to cooperate as a defense to an action for breaching its duty to defend or indemnify its insured. *See Smith v. Nationwide Mut. Ins. Co.*, 830 A.2d 108 (Vt. 2003). However, the insurer has a significant burden to carry and must establish the insured failed to cooperate, that failure prejudiced the insurer, and the insurer diligently pursued the defense of the action against the insured. *See id.*; *see also City of Burlington v. Hartford Steam Boiler Inspection & Ins. Co.*, 190 F.Supp.2d 663, 682 (D.Vt. 2002) (While the Court finds no *express* contractual duty imposed on HIC, under Vermont law "the parties to an insurance contract owe each other mutual duties of good faith and stand in the position of fiduciaries in relation to each other." (Emphasis in original)).

- What are the recoverable damages for the bad faith cause of action?

  - "The insured's damages are the difference between the judgment and the policy limit, plus interest and costs." *Myers v. Ambassador Ins. Co.*, 508 A.2d 689, 692 (Vt. 1986).

  - An insured can possibly recover damages for emotional distress. *Buote v. Verizon New England*, 249 F. Supp. 2d 422, 433 n.11 (D. Vt. 2003).

  - There is an indication that an insured could recover punitive damages in appropriate circumstances. *See Martell v. Universal Underwriters Life Ins. Co.*, 564 A.2d 584, 589 n.2 (Vt. 1989).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - While no Vermont case directly addresses the standard for recovering punitive damages in the context of a bad faith case, the Vermont Supreme Court has expressed a willingness to permit an insured to recover punitive damages where the breach of the duty of good faith in the insurance contract was "willful and wanton or fraudulent." *See Martell v. Universal Underwriters Life Ins. Co.*, 564 A.2d 584, 589 n.2 (Vt. 1989); *see also Phillips v. Aetna Life Ins. Co.*, 473 F. Supp. 984 (D. Vt. 1979) (predicting Vermont State Courts would recognize an "insurer's reckless disregard and rejection of insured's

Bona fide medical claim constitutes an actionable tort under Vermont law, for which consequential and punitive damages may be awarded.") The insurer's conduct must have constituted bad faith "by willful or reckless concealment of coverage, which it knew, or should have known, that the plaintiff was entitled to receive." *Id.* at 990.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - No Vermont decision has yet to address this issue.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. See *LaRocque v. State Farm Ins. Co.*, 660 A.2d 286, 288 (Vt. 1995).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. *Peerless Ins. Co. v. Frederick*, 869 A.2d 112, 116 (Vt. 2004) ("Whether the claim is for tortious or contractual bad faith, an insured/insurer relationship is still a prerequisite to sustain the claim.")

    - The Supreme Court of Vermont has held that a liability insurer owed no duty to accident victims to settle a lawsuit in good faith. *LaRocque v. State Farm Ins. Co.*, 660 A.2d 286, 288 (Vt. 1995). The court stated that it is "unpersuaded that any such duty exists at common law" when a liability insurer refuses to settle a third-party claim. *Id.*

VIRGINIA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? Yes, in certain circumstances.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Virginia Code §§ 38.2-209 and 8.01-66.1 provide for private causes of action for insureds.

    - Virginia Code § 8.01-66.1 addresses bad faith in the context of "motor vehicle insurance policies."

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Under Virginia law, there is a common law cause of action sounding in contract. *Aetna Cas. & Sur. Co. v. Price*, 146 S.E.2d 220, 228 (Va. 1966). *See also A & E Supply Co. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 676 (4th Cir. 1986) (holding that "in a first-party Virginia insurance relationship, liability for bad faith conduct is a matter of contract rather than tort law.")

    - Virginia courts apply a reasonableness test when determining whether an insurer has committed bad faith. This evaluation requires consideration of the following factors:

        - "whether reasonable minds could differ in the interpretation of policy provisions defining coverage and exclusions;

        - whether the insurer has made a reasonable investigation of the facts and circumstances underlying the insured's claim;

        - whether the evidence discovered reasonably supports a denial of liability;

        - whether it appears that the insurer's refusal to pay was used merely as a tool in settlement negotiations; and

        - whether the defense the insurer asserts at trial raises an issue of first impression or a reasonably debatable question of law or fact." *Nationwide Mut. Ins. Co. v. St. John*, 524 S.E.2d 649, 651 (Va. 2000) (citing *CUNA Mut. Ins. Soc'y v. Norman*, 375 S.E.2d 724, 727 (Va. 1989)).

    - An insured must demonstrate that the disputed claim was covered under the policy before a recovery is allowed. *Reisen v. Aetna Life & Cas. Co.*, 302 S.E.2d 529, 533 (Va. 1983).

- What are the applicable statutes of limitations?

    - 5 years for breach of contract claims. Va. Code Ann. § 8.01-246(2).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Generally, insurers may raise defenses based off of the factors, *supra*, in *CUNA Mut. Ins. Soc'y*.

- What are the recoverable damages for the bad faith cause of action?

    - Attorney fees are recoverable. *See* Va. Code Ann. §§ 38.2-209 and 8.01-66.1.

    - Consequential damages are recoverable on a limited basis. See *A & E Supply Co. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 677-78 (4th Cir. 1986).

- Are punitive damages recoverable? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- Generally, punitive damages are not allowed. However, Virginia Code §§ 8.01-66.1(A) and (B) allows a policyholder to recover a punitive remedy in motor vehicle insurance cases upon a finding of bad faith. *See* Va. Code Ann. § 8.01-66.1.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source, (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Virginia Code § 8.01-66.1(B) provides that a third-party claimant who brings a claim for $3,500 or less under a "motor vehicle policy" may recover "an amount double the amount of the judgment awarded . . . together with reasonable attorney's fees and expenses." Va. Code Ann. § 8.01-66.1.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Under Virginia law, a third-party beneficiary theoretically can bring a common law bad faith cause of action upon the showing that at the time of contracting, the parties to the policy expressed a clear and definite intent to confer a benefit upon the third-party. See *Fireman's Fund Ins. Co. v. St. Asaph Lawyer's Title Co.*, 213 B.R. 482, 483 (Bankr. E.D. Va. 1997).

WASHINGTON

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - **WA Insurance Fair Conduct Act (IFCA) & The Consumer Protection Act (CPA)**

        - It is established that insureds may bring a private action against their insurers for breach of duty of good faith under the IFCA and the CPA. A violation of the statutes governing IFCA and CPA is a per se violation. Only an insured may bring a *per se* action; however, an insured may assign their claims to a third-party.

        - *Tank v. State Farm Fire & Casualty Co*., 105 Wn.2d 381, 393-94, 715 P.2d 1133 (1986); *Besel v. Viking Ins. Co. of Wisconsin*, 146 Wn.2d 730, 49 P.3d 887 (2002); Revised Code of Washington (RCW) 49.30.015; Washington Administrative Code (WAC) 19.86.050.

    - **IFCA**

        - The IFCA establishes a private cause of action for insurance policyholders to sue their insurance companies if they believe the company has "unreasonably" denied their claim or has violated particular regulations governing unfair claims settlement practices. Some violations actionable under IFCA include: 1) misrepresentation of policy

provisions; 2) failure to acknowledge communications; and 3) failure to promptly and adequately investigate a claim.

- In addition, IFCA provides for damages equal to three times the actual damages sustained by the policyholder, as well as other costs, including attorneys' fees and court costs. RCW 48.30.015(2).

- Prior to commencing suit under the IFCA, the claimant must provide written notice of the basis for the action to the insurer and to the Office of the Insurance Commissioner. If the insurer fails to "resolve the basis for the action" within 20 days, the claimant "may bring action without any further notice." RCW 48.30.015(8).

- Since its passage in late 2007, there have been no Washington State Trial or Appellate Court decisions discussing or analyzing IFCA. The Washington State Court cases where a claim under IFCA was brought were dismissed, usually via Summary Judgment on other grounds.

- There have been a handful of federal district court cases in which IFCA is discussed. These decisions preview how the law may evolve at the WA State court level. The Federal opinions have found:

    - Only a first-party claimant to a policy of insurance who is unreasonably denied a claim for coverage or payment of benefits from an insurer may bring an action to recover the actual damages sustained. *Hartford Fire Ins. Co. v. Leahy*, 774 F.Supp. 2d 1104, 1122 (W.D. Wash., March 1, 2011).

    - IFCA is to be applied prospectively only; there is no retroactive applicability. *HSS Enterprises, LLC v. Amco Ins. Co.*, 2008 WL 312695 (W.D. Wash., Feb. 1, 2008); *Malbco Holdings, LLC v. Amco Ins. Co.*, 546 F.Supp.2d 1130, 1133 (E.D. Wash., March 11, 2008).

- Pre-IFCA enactment conduct (e.g. the denial of a claim) cannot form the basis of a present and/or a continuing IFCA violation. One Court said that resubmission of a claim and the subsequent wrongful denial of coverage after IFCA was approved was not a new or continuing violation. *Malbco Holdings, LLC v. Amco Ins. Co*., 546 F.Supp.2d 1130, 1134 (E.D. Wash., March 11, 2008).

- Confirmation of a prior denial of coverage, where that confirmation occurs after the date IFCA was enacted, does not constitute a denial sufficient to bring an IFCA claim. *Shepard v. Foremost Ins. Co., Inc*., 2008 WL 5143024 (W.D. Wash., December 05, 2008).

- Denial of coverage is the predicate event for an IFCA claim. Where the insurer denies coverage before IFCA went into effect, the IFCA claim must fail. A renewed demand made after the effective date of IFCA is not a predicate event for an IFCA claim because it does not contain any different information or evidence than what had already been submitted. *Keith v. CUNA Mut. Ins. Agency, Inc*., 2009 WL 1793675, (W.D. Wash., June 23, 2009).

- Even new information submitted with an appeal of a claim denied before IFCA was enacted was not enough to trigger an IFCA cause of action. The court said the critical date is the date of the original denial of the claim. It referred to the original denial as the "precipitating event." *Rinehart v. Life Ins. Co. of North America*, 2009 WL 529524 (W.D. Wash., March 02, 2009).

- The treble damages provision of IFCA can be used as a basis to meet the $75,000 amount in controversy requirement for cases defendants seek to remove to federal court. So, where a plaintiff makes a $25,000 property damage claim and also makes an IFCA claim, the defense can use the multiplier in IFCA to

meet the amount in controversy requirement for removal to federal court. *Burke Family Living Trust v. Metropolitan Life Ins. Co.*, 2009 WL 2947196 (W.D. Wash., September 11, 2009) (allowing the triple damages to be used to meet the amount in controversy).

- **CPA**

  - In order to recover damages under the Consumer Protection Act, a private party must prove that the defendant's act or practice (1) is unfair and deceptive, (2) occurs in the conduct of trade or commerce, (3) impacts the public interest, (4) causes injury to the plaintiff's business or property, and (5) causes the injury suffered. RCW § 19.86.020.

  - Unfair and deceptive acts include violations of WAC 284-30-330, "Unfair Claims Settlement Practices."

    - WAC 284-30-330 delineates specific unfair claims settlement practices. It states in pertinent part:

      The following are hereby defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance, specifically applicable to the settlement of claims:

      (1) Misrepresenting pertinent facts or insurance policy provisions.

      (2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

      (3) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies.

      (4) Refusing to pay claims without conducting a reasonable investigation. . . .

(6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear. . . .

(8) Attempting to settle a claim for less than the amount to which a reasonable person would have believed he or she was entitled by reference to written or printed advertising material accompanying or made part of an application. . . .

(11) Delaying the investigation or payment of claims by requiring a first party claimant or his or her physician to submit a preliminary claim report and then requiring subsequent submissions which contain substantially the same information.

(12) Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage. . . .

(15) Failing to expeditiously honor drafts given in settlement of claims. A failure to honor a draft within three working days after notice of receipt by the payor bank will constitute a violation of this provision. Dishonor of a draft for valid reasons related to the settlement of the claim will not constitute a violation of this provision. . . .

- An act that impacts the public interest is one that: (1) violates a statute that incorporates RCW 19.86; (2) violates a statute that contains a specific legislative declaration of public interest impact; or (3)(a) injured other persons; (b) had the capacity to injure others; or (c) has the capacity to injure others. RCW 19.86.093.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- An insurer has a duty of good faith to its policy-holder, and violation of that duty may give rise to a tort action for bad faith.

- To prove bad faith the policyholder must show the insurer's breach of the insurance contract was unreasonable, frivolous, or unfounded. Whether an insurer acted in bad faith is a question of fact. *Am. States Ins. Co. v. Symes of Silverdale, Inc*., 150 Wn.2d 462, 470, 78 P.3d 1266 (2003).

- Insurers owe insureds a duty of good faith. Under this duty, an insurer must deal fairly with an insured, give equal consideration in all matters to an insured's interests, thoroughly investigate an insured's accident or injuries, provide defense counsel that will represent only the insured, disclose all material information to the insured, and refrain from placing its own monetary interest above an insured's financial risk. WAC 284-30-330 (2012); *Dussault v. Am. Int'l Group Inc*., 123 Wn. App. 863, 869-70, 99 P.3d 1256 (2004).

- What are the applicable statutes of limitations?

  - Under the CPA, a claimant must bring a cause of action within 4 years of discovery.

  - The statute enacting IFCA does not specify a SOL. The statute is most similar to the CPA and it is possible that the courts will apply the CPA's 4 year SOL. However, Washington courts in the past have applied various SOL to insurance claims based on the type claim (tort v. contract) being made.

  - A 3-year statute of limitations for tort claims, applies to an action by insured against insurer arising out of injuries suffered by the insured while a passenger in her own automobile driven by a person with no liability insurance who was at fault in the accident. Although the driver was a covered person under the terms of the insured's liability coverage, the insured's cause of action against the driver was the same as for any other third party claimant with a claim against a tortfeasor's insurer. Thus, her claim was grounded in tort rather than contract. *Rones v. Safeco Ins. Co. of America*, 119 Wash.2d 650, 654-55, 835 P.2d 1036 (1992).

- A 6-year contract statute of limitation applies to an insured's action against his or her insurer for benefits under insurance policy. The language in the contract of insurance, requiring the insurer to pay damages which the insured was legally entitled to recover from the owner or operator of an uninsured motor vehicle, did not displace the statute of limitation otherwise applicable to all written contracts. *Safeco Ins. Co. v. Barcom*, 112 Wn.2d 575, 584, 773 P.2d 56 (1989).

- A 1-year limitation of actions provision in standard fire insurance policy was not precluded by the general statute of limitations or other statutory provisions and did not violate the equal protection clause of the Fourteenth Amendment or the privileges and immunities clause of the State Constitution. *Ashburn v. Safeco Ins. Co. of Am*., 42 Wn. App. 692, 695, 713 P.2d 742 (1986); RCW 4.16.040.

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - IFCA: To date very few IFCA cases have been litigated. The only recognized defenses so far are (1) the act of bad faith must have occurred after the initiative enacted on December 6, 2007, and (2) only a first-party insured may bring the action.

  - If the IFCA's application parallels the application of the CPA, the issues of reasonableness and equal consideration, based on WAC 284-30-330, "Unfair Claims Settlement Practices", will be the primary issues of debate.

  - If the insured claims that the insurer denied coverage unreasonably in bad faith, then the insured must come forward with evidence that the insurer acted unreasonably. The policyholder has the burden of proof. The insurer is entitled to summary judgment if reasonable minds could not differ that its denial of coverage was based upon reasonable grounds.

  - If the insurer can point to a reasonable basis for its action, this reasonable basis is significant evidence that it did not act in bad faith and may even establish that reasonable minds could not differ that its denial of coverage was justified. However, the existence of

some theoretical reasonable basis for the insurer's conduct does not end the inquiry. The insured may present evidence that the insurer's alleged reasonable basis was not the actual basis for its action, or that other factors outweighed the alleged reasonable basis. *Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 486, 78 P.2d 1274 (2003).

- Insurers owe insureds a duty of good faith. Under this duty, an insurer must deal fairly with an insured, give equal consideration in all matters to an insured's interests, thoroughly investigate an insured's accident or injuries, provide defense counsel that will represent only the insured, disclose all material information to the insured, and refrain from placing its own monetary interest above an insured's financial risk. *Dussault v. Am. Int'l Group, Inc.*, 123 Wn. App. 863, 869-70, 99 P.3d 1256 (2004).

- What are the recoverable damages for the bad faith cause of action?

  - **IFCA:** Upon a finding of a violation of the IFCA, the court must award attorney's fees, actual and statutory litigation costs including expert witness fees, and other litigation costs. Additionally, under IFCA the court also may increase the total award of damages, in an amount not to exceed three times the actual damages. RCW 48.30.015.

    - Additionally, the Insurance Commissioner may take action under the insurance code for violation of a regulation. RCW 48.30.015.

  - Where an insurer wrongfully refuses to defend, it will be required to pay the judgment or settlement to the extent of its policy limits and also to reimburse the insured for his costs reasonably incurred in defense of the action. *Waite v. Aetna Casualty & Sur. Co.*, 77 Wn.2d 850, 852, 467 P.2d 847 (1970).

  - **CPA:** Treble the amount of actual damages, up to $25,000, may be awarded for violations of the CPA. *Tortev. Durham & Bates Agencies Inc.*, 116 Wn. App. 516, 67 P.3d 506 (2003). Further, the court may award actual damages, and the costs of the suit, including attorney's fees which may be calculated using the "lodestar"

calculation. *Etheridge v. Hwang*, 105 Wn. App. 447, 461-62, 20 P.3d 958 (2001); RCW 19.86.090.

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Punitive damages are not allowed in Washington State unless specifically authorized by statute. Neither IFCA nor CPA specifically authorizes punitive damages, though both allow the trebling of actual damages (with a limit of $25,000 in CPA claims).

- Are punitive damages insurable?

    - Yes, the Washington Supreme Court has ruled that there is no public policy against insurance coverage for punitive damages. However, Washington courts regard such damages as inappropriate in civil cases because they encroach upon criminal sanctions. *Fluke Corp. v. Harford Acc. & Indem.Co.*, 145, 148 Wn.2d 137, 34 P.3d 809 (2001).

- Can punitive damages, assessed against the insured after the insurer fails to settle, be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - Punitive damages are not allowed in Washington State unless specifically authorized by statute. Neither IFCA nor CPA specifically authorizes punitive damages, though both allow the trebling of actual damages (with a limit of $25,000 in CPA claims). RCW 48.30.010.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - Insurers have a duty to supply the insured with an attorney who will properly represent their interests. If, because of a conflict of interest, the attorney cannot properly represent the insured, it is incumbent upon the insurer to obtain and pay for an attorney who can properly represent the insured. *Hamilton v. State Farm Mut. Auto. Ins. Co.*, 9 Wn.App. 180, 186-87, 511 P.2d 1020 (1973).

- When an insurer is defending under a reservation of rights, the insurer has an obligation to retain and pay for competent defense counsel who are loyal only to the insured. *Tank v. State Farm Fire & Cas. Co.*, 105 Wn. 2d 381, 287-88, 715 P.2d 1133 (1986).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

  - No. The principal (insurer) is not liable for the acts of defense attorneys who are acting as independent contractors. *Evans v. Steinberg*, 40 Wn. App. 585, 588, 599 P.2d 797 (1988).

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

  - A third-party claimant may not sue an insurer directly for breach of the insurer's duty of good faith under the liability policy, the IFCA, or the CPA. The first-party may assign their rights to a third-party claimant and the third-party claimant assumes all the claims in the same standing that the first-party had. *Tank v. State Farm Fire & Casualty Co.*, 105 Wn.2d 381, 393, 715 P.2d 1133 (1986).

  - However, under the CPA, non-consumers and non-parties to a business relationship may bring claims for deceptive acts. *Panag v. Farmers Ins. Co. of Washington*, 166 Wn.2d 27, 43-44, 204 P.3d 885 (2009).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - No. Insurers do not owe a duty of good faith to third-party claimants. However, insurer has a duty to avoid intentional tortuous acts (including, intentional infliction of emotional distress and fraudulent misrepresentation). *Dussault v. Am. Int'l Group*, 123 Wn. App. 863, 869, 99 P.3d 1256 (2004).

- What are the applicable statutes of limitations?

    - The same as for a first-party claimant, see above. Three years for tort actions; four years under the CPA; six years for breach of contract claims; and not less than 1 year under the policy provisions.

WASHINGTON, D.C.

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? No, with first party policy claims suit may only be based on a theory of breach of contract. With third party policy claims, no controlling D.C. decision has specifically ruled on this issue, but D.C. would probably permit a bad faith claim for failure to settle.

- Can third parties sue for bad faith (i.e., third party bad faith)? No case permits such claims.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. Although D.C. has prohibitions against unfair claims practices, including a failure to pay a claim for a reason that is arbitrary or capricious based on all available information, D.C. Code §31-2231.17, this provision specifically does not "create or imply a private cause of action for a violation of this chapter." D.C. Code §31-2231.02(a).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Not in the context of first party policy claims. The D.C. Court of Appeals (the highest court of this jurisdiction) has specifically rejected the argument that there should be a common law cause of action in tort for bad faith by an insurer in handling of first party claims. *Choharis v. State Farm Fire & Cas. Co.*, 961 A.2d 1080, 1087 (D.C. 2008):

        > Disputes relating to the respective obligations of the parties to an insurance contract should generally be addressed within the principles of law relating to

> contracts, and bad faith conduct can be compensated within those principles. We see no compelling basis for complicating matters by intertwining such disputes with considerations peculiar to tort.
>
> * * * *
>
> If there is something special in the insurance relationship that calls for protection of policy holders beyond that provided by contract principles, such a determination is one most appropriately to be made by the legislature.

The *Choharis* court cited with approval the United States District Court opinion of Judge John Bates in *Fireman's Fund Ins. Co. v. CTIA-The Wireless Ass'n.*, 480 F. Supp.2d 7 (DDC 2007)(rejecting a claim for bad faith under tort principles for insurer's alleged bad faith failure to provide a defense in suits against its insured).

- In the context of third party policy claims, a bad faith claim by an insured against the insurer would probably be permitted for failure to settle. The D.C. Court of Appeals has never specifically ruled on whether there can be a tort-based cause of action. The Court of Appeals has pointed out that "every contract [of insurance] contains within it an implied covenant to act in good faith and damages may be recovered for its breach as part of a contract action. Disputes relating to the respective obligations of the parties to an insurance contract should generally be addressed within the principles of law relating to contracts . . . ." *Choharis*, 961 A.2d at 1087. However, the *Choharis* decision cited with approval Maryland law on this question. 961 A.2d at 1088; see also *Fireman's Fund Ins. Co. v. CTIA-The Wireless Ass'n.*, 480 F. Supp.2d at 11 (Maryland law "is the basis for the District of Columbia's common law and therefore is 'an especially persuasive authority when the District's common law is silent.'" (quoting *Napolean v. Heard*, 455 A.2d 901, 903 (D.C. 1983)). "Maryland law does recognize a bad faith tort based on an insurer's failure to *settle* a third party claim . . . ." *Fireman's Fund*, 480 F. Supp.2d at 11. However, as the *Fireman's Fund* decision pointed out, Maryland law has not recognized a bad faith failure in the third party coverage context beyond that situation (in particular, no cause of action has been permitted based

on alleged bad faith failure to *defend* because of an alleged lack of coverage). *Id*.

The Maryland tort cause of action is based on a conclusion that there is a fiduciary duty on the part of the insurer. *Mesmer v. Maryland Auto Ins. Fund,* 353 Md. 241, 263, 725 A.2d 1053, 1064 (1999). The *Choharis* decision of the D.C. Court of Appeals specifically did "not exclude the possibility of fiduciary principles coming into play in certain third-party situations, such as where the insurance company is involved in a settlement of a third-party claim or directs the actual course of the defense." 961 A.2d at 1090, n. 15.

- What are the applicable statutes of limitations?

    - Three years. DC. Code §12-301(7). The D.C. Court of Appeals has indicated that the cause of action accrues at the time of the breach of contract, but has applied the "discovery rule" to situations "where the relationship between the fact of injury and the alleged [wrongful] conduct is obscure when the injury occurs. *Murray v. Wells Fargo Home Mortgage,* 953 A.2d 308, 321 (D.C. 2008) (quoting *Bussineau v. President and Directors of Georgetown College,* 518 A.2d 423, 425 (D.C. 1986)).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Not applicable in the absence of a separate tort of bad faith in the context of first party claims.

    - In the event the D.C. courts would follow the Maryland approach of permitting a tort claim for bad faith failure to settle, "the presence of one or more of the following acts or circumstances may affect the 'good faith' posture of the insurer: the severity of the plaintiff's injuries giving rise to the likelihood of a verdict greatly in excess of the policy limits; lack of proper and adequate investigation of the circumstances surrounding the accident; lack of skillful evaluation of plaintiff's disability; failure of the insurer to inform the insured of a compromise offer within or near the policy limits; pressure by the insurer on the insured to make a

contribution towards a compromise settlement within the policy limits, as an inducement to settlement by the insurer; and actions which demonstrate a greater concern for the insurer's monetary interests than the financial risk attendant to the insured's predicament." *State Farm Auto Ins. Co. v. White,* 248 Md. 324, 332, 236 A.2d 269, 273 (1967).

- What are the recoverable damages for the bad faith cause of action?

    - In the first party claim context, only damages recoverable in contract. *Choharis v. State Farm Fire & Cas. Co.,* 961 A.2d 1080, 1087 (D.C. 2008).

    - Inasmuch as any recovery for bad faith failure to settle would depend upon the D.C. courts applying Maryland law, they would most likely look to Maryland law for the measure of damages. "Ordinarily the measure of damages in a bad faith failure to settle case is the amount by which the bonafide judgment rendered in the underlying action exceeds the amount of insurance coverage." *Kremen v. Md. Auto Ins. Fund,* 363 Md. 663, 675, 770 A.2d 170, 177 (2001).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Punitive damages would probably not be permitted unless some recognized tort other than an allegation of bad faith is proved. "[Where the basis of a complaint is, as here, a breach of contract, punitive damages will not lie, even if it is proved that the breach was willful, wanton, or malicious." *Choharis v. State Farm Fire & Cas. Co.,* 961 A.2d 1080, 1090 (D.C. 2008) (quoting *Sere v. Group Hospitalization, Inc*., 443 A.2d 33, 37 (D.C.), *cert. denied*, 459 U.S. 912 (1982)). *See also*, *Fireman's Fund Ins. Co. v. CTIA-The Wireless Ass'n.,* 480 F. Supp.2d 11, 13-15.

    - However, there is an exception expressed in *Choharis* where an insured may recover punitive damages for a breach of contract action. Only where the alleged breach of contract "merges with,

and assumes the character of, a willful tort," will the insured be able allowed to recover punitive damages. *Id.*

- In the event such damages are permitted, the tortuous conduct by defendant "must have been outrageous, characterized by malice, wantonness, gross fraud, recklessness, or willful disregard of the plaintiff's rights." *Choharis,* 961 A.2d at 1090 (quoting *Sere v. Group Hospitalization, Inc*., 443 A.2d 33, 37 (D.C.), *cert. denied*, 459 U.S. 912 (1982)). The only reported D.C. case permitting punitive damages in such a case was *Central Armature Works, Inc. v. American Motorists Ins. Co.*, 520 F.Supp. 283 (D.D.C. 1981). Not only was that case a rather egregious one, involving a finding that the insurer coerced the insured into relinquishing its rights under the policy, but it has been severely criticized by subsequent decisions, most recently by *Fireman's Fund Ins. Co. v. CTIA-The Wireless Ass'n.*, 480 F. Supp.2d 11, 15 (*Central Armature* is "a questionable source of law"), and by *Thorpe v. Banner Life Ins. Co.*, 632 F.Supp.2d 8, 19 (D.D.C. 2009).

- Are punitive damages insurable?

  - While not directly addressing if punitive damages are insurable, as stated in *Hartford Life Ins. Co. v. Title Guarantee Co.*, 520 F.2d 1170, C.A.D.C. (1975), it is settled law that a person may insure himself against the results of his own negligent violations of law. *Id.* at 1175 (citing 15 Williston on Contracts, P 1749A, p. 138; Recent Decisions Note: "Insurance Public Policy Liability of Insurer for Punitive Damages and Penalties", 40 Mich.L.Rev. 128 (1941), *citing* 6 Blashfield, Encyclopedia of Automobile Law and Practice, s 3974 (1935)). It is only for the knowledgeable and intentional wrongdoer that the practice of voiding insurance contracts as being contrary to public policy is reserved. *Id. (referring to Northwestern National Casualty Co. v. McNulty,* 307 F.2d 432, 442 (5th Cir. 1962)

  - If D.C. courts were to apply Maryland law (as they sometimes do in the absence of D.C. precedent), they would likely permit punitive damages to be insurable. Maryland courts have held that public policy did not preclude coverage under liability insurance policy for exemplary damages assessed against insured. *First Nat. Bank of*

St. Mary's v. Fidelity & Deposit Co., 283 Md. 228, 389 A.2d 359, 362 (Md.1978).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - D.C. has yet to approve the cause of action for bad faith failure to settle, and has not yet ruled on whether punitive damages are insurable. If D.C. follows Maryland law on these issues (as it sometimes does in the absence of D.C. precedent), then it would hold that punitive damages can be insurable, and it may follow that an excess judgment can include them.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - D.C. has not issued a controlling ruling on this issue. However, under Maryland law, to which D.C. looks in the absence of its own authority, if there is an *actual* conflict of interest, independent counsel paid for by the insurer may be required. *Brohawn v. Transamerica Ins. Co*., 276 Md. 396, 347 A.2d 842 (1975). However, the mere presence of a bad faith failure to settle does not create an actual conflict so as to entitle the insured to reimbursement for its own independent counsel fees incurred in the defense of the case. *Allstate Ins. Co. v. Campbell*, 639 A.2d 652, 334 Md. 381 (1994).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - D.C. has not addressed this issue in any of its cases. Most cases where the insured asserts malpractice of their appointed attorney are directed to the attorney's malpractice insurance provider, not the liability insurer that appointed the attorney. Furthermore, Maryland has not issued a controlling ruling on this issue.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. See D.C. Code §31-2231.02(a).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No.

WEST VIRGINIA

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? No. However, third parties may bring a cause of action under the West Virginia Human Rights Act against insurers when they assert that the insurer's failure to settle or negotiate in good faith was borne of a discriminatory animus. *See Michael v. Appalachian Heating, LLC*. (2010) 226 W.Va. 394. Significantly, the Court's decision in *Michael* was the subject of a rehearing conference on September 9, 2010, and before any further opinion was issued the matter was settled and dismissed with prejudice. 2010 WL 5547681.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Yes. At the outset, it is noteworthy that the Supreme Court of Appeals of West Virginia has explained that a "bad faith" action differs from a statutory cause of action. In particular, the Court provided that:

> the phrase "bad faith" is used to refer to the state's "unfair settlement practices" statute. However, there is actually a technical distinction between a "bad faith" claim and an "unfair settlement practices" claim. The phrase "bad faith" was developed to describe the common law action against an insurer. The phrase "unfair settlement practices" was developed to describe the statutory action against an insurer. Because the statutory claim actually includes the elements of a cause of action for the common law claim, our cases use the two phrases interchangeably.
>
> *Light v. Allstate Ins. Co.,* 506 S.E.2d 64, 68 n.5 (W. Va. 1998).

- As to the statutory cause of action, West Virginia Code §33-11-4(9), entitled "Unfair claim settlement practices," is considered the bad faith statute. It is part of the West Virginia Unfair Trade Practices Act, W. Va. Code §33-11-1, et seq., which prohibits unfair competition and unfair or deceptive acts or practices by insurers and their agents. Section 33-11-4(9) provides as follows:

> *No person shall commit or perform with such frequency as to indicate a general business practice any of the following:*
>
> *(a) Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;*
>
> *(b) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;*
>
> *(c) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;*
>
> *(d) Refusing to pay claims without conducting a reasonable investigation based upon all available information;*
>
> *(e) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;*
>
> *(f) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;*
>
> *(g) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by the insureds, when the insureds have*

made claims for amounts reasonably similar to the amounts ultimately recovered;

(h) Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;

(i) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured;

(j) Making claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which payments are being made;

(k) Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;

(l) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;

(m) Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage;

(n) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement;

(o) Failing to notify the first party claimant and the

provider(s) of services covered under accident and sickness insurance and hospital and medical service corporation insurance policies whether the claim has been accepted or denied and if denied, the reasons therefor, within fifteen calendar days from the filing of the proof of loss: Provided, That should benefits due the claimant be assigned, notice to the claimant shall not be required: Provided, however, That should the benefits be payable directly to the claimant, notice to the health care provider shall not be required. If the insurer needs more time to investigate the claim, it shall so notify the first party claimant in writing within fifteen calendar days from the date of the initial notification and every thirty calendar days, thereafter; but in no instance shall a claim remain unsettled and unpaid for more than ninety calendar days from the first party claimant's filing of the proof of loss unless, as determined by the Insurance Commissioner, (1) there is a legitimate dispute as to coverage, liability or damages; or (2) the claimant has fraudulently caused or contributed to the loss. In the event that the insurer fails to pay the claim in full within ninety calendar days from the claimant's filing of the proof of loss, except for exemptions provided above, there shall be assessed against the insurer and paid to the insured a penalty which will be in addition to the amount of the claim and assessed as interest on the claim at the then current prime rate plus one percent. Any penalty paid by an insurer pursuant to this section shall not be a consideration in any rate filing made by the insurer.

W. Va. Code §33-11-4(9).

- Although the Unfair Trade Practices Act and its unfair claim settlement practices subsection do not expressly provide for a private cause of action where there have been violations, the Supreme Court of Appeals of West Virginia has held that an implied cause of action exists for a violation of Section 33-11-4(9). Syl. pt. 2, in part, *Jenkins v. J.C. Penney Cas. Ins. Co.*, 280 S.E.2d 252 (W. Va. 1981), overruled on other grounds by *State ex rel.State Farm Fire & Cas. Co. v. Madden*, 451 S.E.2d 721 (W. Va. 1994). To show entitlement to recovery on a

private cause of action under subdivision (9), a plaintiff must show: (1) that there has been a violation or that there have been multiple violations of that subsection in the management of the plaintiff's claim; and (2) that the violation or violations entailed "a general business practice" on the part of the insurer. *McCormick v. Allstate Ins. Co.*, 475 S.E.2d 507, (W. Va. 1996).

- Keep in mind that the West Virginia Insurance Commissioner has promulgated various rules that further regulate the insurance industry and define particular unfair claims settlement practices. For example, Section 114-14-3 of the West Virginia Code of State Rules governs the necessary contents of an insurer's claims files, Section 114-14-4 speaks to an insurer's representation of policy provisions and benefits, and Section 114-14-5 provides standards for an insurer's acknowledgement of pertinent communications from an insured. Section 114-14-6 sets forth "standards for prompt investigations and fair and equitable settlements applicable to all insurers," and Section 114-14-7 provides additional standards that apply specifically to settlement of automobile insurance claims.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - Yes. In syllabus point 1 of *Hayseeds, Inc. v. State Farm Fire & Casualty*, 352 S.E.2d 73 (W. Va. 1986), the Supreme Court first recognized a common law bad faith claim when it announced that "whenever a policyholder substantially prevails in a property damage suit against its insurer, the insurer is liable for: (1) the insured's reasonable attorneys' fees in vindicating its claim; (2) the insured's damages for net economic loss caused by the delay in settlement, and damages for aggravation and inconvenience." Notably, a policyholder need not show that the insurer acted "wrongfully" or "unreasonably" in order to recover for common law bad faith; rather, he or she need only "substantially prevail." *Id*. at 80. The principles underlying *Hayseeds* were extended to first-party claims concerning uninsured and underinsured motorist coverage. *See* syl. pt. 6, *Marshall v. Saseen*, 450 S.E.2d 791 (W. Va. 1994) (providing that "when a policyholder of uninsured or

underinsured motorist coverage issued pursuant to W. Va. Code §33-6-31(b) substantially prevails in a suit involving such coverage under W. Va. §33-6-31(d), the insurer issuing such policy is liable for the amount recovered up to policy limits, the policyholder's reasonable attorney fees, and damages proven for aggravation and inconvenience.").

- The Court defined "substantially prevails" in Syllabus Point 1 of *Jordan v. National Grange Mutual Ins. Co.*, 183 W. Va. 9, 393 S.E.2d 647 (1990), as it explained that "an insured 'substantially prevails' in a property damage action against his or her insurer when the action is settled for an amount equal to or approximating the amount claimed by the insured immediately prior to the commencement of the action, as well as when the action is concluded by a jury verdict for such an amount. In either of these situations the insured is entitled to recover reasonable attorney's fees from his or her insurer, as long as the attorney's services were necessary to obtain payment of the insurance proceeds."

- Additionally, "wherever there is a failure on the part of an insurer to settle within policy limits where there exists the opportunity to settle and where such settlement within policy limits would release the insured from any and all personal liability, the insurer has prima facie failed to act in its insured's best interest and such failure to so settle prima facie constitutes bad faith toward its insured." Syl. pt. 2 *Shamblin v. Nationwide Mut. Ins. Co.,* 396 S.E.2d 766 (W. Va. 1990).

- What are the applicable statutes of limitations?

  - The statute of limitations for both statutory and common law bad faith claims is one year. *See* syl. pt. 1, *Wilt v. State Auto. Ins. Co.,* 506 S.E.2d 608 (W. Va. 1998) (finding that statutory bad faith claims have a one year statute of limitations); *Noland v. Va. Ins. Reciprocal*, 686 S.E.2d 23, 35 (W. Va. 2009) (holding that one year statute of limitations applies to common law claims).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

- An insurer may affirmatively show that its actions comported with the provisions of West Virginia Code § 33-11-4(9) and the corresponding rules. An insurer may also assert the affirmative defense of the statute of limitations.

- Also, where an insurer has failed to settle a claim within policy limits and had the opportunity to do so, the insurer may be held liable for a jury verdict in excess of policy limits. Under those circumstances:

    - It will be the insurer's burden to prove by clear and convincing evidence that it attempted in good faith to negotiate a settlement, that any failure to enter into a settlement where the opportunity to do so existed was based on reasonable and substantial grounds, and that it accorded the interests and rights of the insured at least as great a respect as its own.

    - In assessing whether an insurer is liable to its insured for personal liability in excess of policy limits, the proper test to be applied is whether the reasonably prudent insurer would have refused to settle within policy limits under the facts and circumstances, bearing in mind always its duty of good faith and fair dealing with the insured. Further, in determining whether the efforts of the insurer to reach settlement and to secure a release for its insured as to personal liability are reasonable, the trial court should consider whether there was appropriate investigation and evaluation of the claim based upon objective and cogent evidence; whether the insurer had a reasonable basis to conclude that there was a genuine and substantial issue as to liability of its insured; and whether there was potential for substantial recovery of an excess verdict against its insured. Not one of these factors may be considered to the exclusion of the others.

      Syl. pts. 3, 4, *Shamblin v. Nationwide Mut. Ins. Co.*, 396 S.E.2d 766 (W. Va. 1990).

- What are the recoverable damages for the bad faith cause of action?

- As to statutory claims, a prevailing plaintiff may recover the increased costs and expenses, including increased attorney fees, resulting from an insurer's use of an unfair business practice and settlement or failure to settle the underlying claim. *McCormick v. Allstate Ins. Co.*, 475 S.E.2d 507, 515 (W. Va. 1996).

- With respect to common law claims, whenever a policyholder substantially prevails in a suit against its insurer, the insurer is liable for: (1) the insured's reasonable attorneys' fees in vindicating its claim; (2) the insured's damages for net economic loss caused by the delay in settlement, and damages for aggravation and inconvenience. Syl. pt. 1, *Hayseeds, Inc. v. State Farm Fire & Casualty*, 352 S.E.2d 73 (W. Va. 1986); Syl. pt. 6, *Marshall v. Saseen*, 450 S.E.2d 791 (W. Va. 1994). "Presumptively, reasonable attorneys' fees in this type of case are one-third of the face amount of the policy, unless the policy is either extremely small or enormously large." *Hayseeds Inc.*,352 S.E.2d at 79-80. Damages for net economic loss include prejudgment interest and other compensatory damages, such as lost profits, if they can be shown to be the result of the delay in paying the claim. *See Smithson v. U.S. Fid. & Guar. Co.*, 411 S.E.2d 850, 861-62 (W. Va. 1991). Damages for aggravation and inconvenience include "damages associated with loss of use of the personal property but relate as well to the aggravation and inconvenience shown in the entire claims collection process." Syl. pt. 4, in part, *McCormick v. Allstate Ins. Co.*, 475 S.E.2d 507 (W. Va. 1996).

- As set forth above, damages in excess of policy limits may be awarded against an insured in accordance with the strictures of *Shamblin v. Nationwide Mut. Ins. Co.,* 396 S.E.2d 766 (W. Va. 1990).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. Punitive damages can be awarded on both statutory and common law claims. *See McCormick v. Allstate Ins. Co.*, 505 S.E.2d 454, 458-59 (W. Va. 1998). However, in order to recover punitive damages, an insured must meet an "actual malice" standard. *Id.* at 459. That is, an "insurer cannot be held liable for punitive damages

by its refusal to pay on an insured's property damage claim unless such refusal is accompanied by a malicious intention to injure or defraud." *Hayseeds, Inc.*, 352 S.E.2d at 74, syl. pt. 2. Moreover, the Court has explained that "punitive damages for failure to settle a property dispute shall not be awarded against an insurance company unless the policyholder can establish a high threshold of actual malice in the settlement process. By 'actual malice' we mean that the company actually knew that the policyholder's claim was proper, but willfully, maliciously and intentionally denied the claim." *Hayseeds, Inc.*, 352 S.E.2d at 79-80.

- Are punitive damages insurable?

    - Yes. Where a policy excluded coverage for intentional acts, "the company is deemed to have intended to cover punitive damages arising from gross, reckless or wanton negligence." *Hensley v. Erie Ins. Co.*, 283 S.E.3d 227, 230 (W.Va. 1981). Public policy is not violated, as gross, reckless, or wanton conduct are still species of negligence.

- Can punitive damages, assessed against the insured after the insurer fails to settle, be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - In *Hensley v. Erie Ins. Co.*, 283 S.E.3d 227 (W.Va. 1981), the Court reversed a judgment on the pleadings by the trial court, holding that a judgment creditor had stated a claim for the recovery from a liability insurer of punitive damages in excess of the insured's policy limits. If the insurer breached the duty to settle, it could be liable for the punitive damages awarded against the insured which were in excess of the policy limit. The court remanded the case for trial, holding that it was for the trial court to determine whether the plaintiffs could develop facts to prove that the insurer breached a duty to settle the underlying case.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

    - No, but the West Virginia Supreme Court has not yet addressed the issue.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - An insurer is not strictly liable for defense counsel's malpractice, but can be held liable if it is aware of defense counsel's misconduct, and directs, uses, or ratifies that conduct. *Rose ex rel. Rose v. St. Paul Fire*, 599 S.E.2d 673 (W. Va. 2004), held that defense counsel represents the interest of an insured, and so are not directly subject to the provisions of West Virginia's Unfair Trade Practices Act (W.Va. Code, 33-11-1 to 33-11-10). But it went on to hold that an insurer's duty under that statute is not delegable. Employing defense counsel to represent the insured does not relieve the insurer of its duties to comply with the Act. Thus, an insurer may be found liable for its own conduct as related to the defense counsel's misconduct. The proof required to make such a claim is two-pronged: First, the claimant must prove that the defense attorney engaged in what constitutes litigation misconduct. (The conduct in this case included out-of-state counsel practicing in several West Virginia counties without seeking *pro hac* admission. The court also hinted that counsel suborned perjured testimony). Second, the claimant must show that the insurer knew that defense counsel's actions constituted litigation misconduct, and still encouraged, direct, participated in, relied upon, or ratified that conduct. *Id.* at 675.

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. The West Virginia legislature expressly eliminated a statutory cause of action for third party bad faith in 2005 with its enactment of West Virginia Code §33-11-4a. Per Section 33-11-4a; a claimant may only file an administrative complaint with the Insurance Commissioner.

    - However, in *Michael v. Appalachian Heating, LLC*. (2010) 226 W.Va. 394, the Supreme Court very recently held that the West Virginia

Human Rights Act, W. Va. Code §5-11-9(7)(A), "prohibits unlawful discrimination by a tortfeasor's insurer in the settlement of a property damage claim when the discrimination is based upon race, religion, color, national origin, ancestry, sex, age, blindness, disability or familial status." Syl. pt. 7. In syllabus point 8, *Michael* held that Section 33-11-4a does not prohibit a third party cause of action against an insurer under the Human Rights Act. Thus, although typical third party actions are not permitted in West Virginia under the Unfair Trade Practices Act, a third party may nevertheless bring an action against an insurer under the Human Rights Act.

- Significantly, the Court's decision in *Michael* was the subject of a rehearing conference on September 9, 2010, and before any further opinion was issued the matter was settled and dismissed with prejudice. 2010 WL 5547681.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

  - No. The Supreme Court has held that there is no common law duty of good faith and fair dealing to third parties. *See* Syl., *Elmore v. State Farm Mut. Auto. Ins. Co.*, 504 S.E.2d 893 (W. Va. 1998).

- What are the applicable statutes of limitations?

  - The statute of limitations to assert a cause of action under the West Virginia Human Rights Act is two years. *See McCourt v. Oneida Coal Co.*, 425 S.E.2d 602, 606 (W. Va. 1992).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - As stated above, a traditional bad faith cause of action cannot be asserted. Rather, a third party may assert that the insurer violated the Human Rights Act in its handling of the third party's claim.

  - The defenses available to the insurer should include those defenses typically available under the Human Rights Act. Thus, the

prosecution of such a claim may be expected to follow a three-step evidentiary framework: (1) the plaintiff has the burden of proving by the preponderance of the evidence a *prima facie* case of discrimination; (2) if the plaintiff succeeds in proving the *prima facie* case, the burden shifts to the defendant to articulate some legitimate nondiscriminatory reason for its actions; and (3) should the defendant carry this burden, the plaintiff must then have the opportunity to prove by a preponderance of the evidence that the legitimate reasons offered by the defendant were not its true reasons, but were a pretext for discrimination. *See Wheeling-Pittsburgh Steel Corp. v. Rowing*, 517 S.E.2d 763 (W. Va. 1999) (following the procedures outlined in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792 (1973)).

- What are the recoverable damages for the bad faith cause of action?

    - Per West Virginia Code §5-11-13(c), if the court finds that the defendant has engaged or is engaging in a discriminatory practice charged in the complaint, the court "*shall enjoin*" the defendant from engaging in such discriminatory practices, and the court may grant any "*legal or equitable relief as the court deems appropriate. In actions brought under this section, the court in its discretion may award all or a portion of the costs of litigation, including reasonable attorney fees and witness fees, to the complainant.*"

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

    - Punitive damages are available to claimants for violations of the Human Rights Act. *See Haynes v. Rhone-Poulenc, Inc*., 521 S.E.2d 331 (W. Va. 1999); *Vandevender v. Sheetz, Inc*., 490 S.E.2d 678 (W. Va. 1997).

WISCONSIN

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes.

- Can third parties sue for bad faith (i.e., third party bad faith)? Generally, No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - Generally, no.

        - An indirect exception is Section 102.18(1)(b), Wis. Stat. which provides the Department of Workforce Development with authority to include a penalty in a worker's compensation award if it determines an employer's or an insurance carrier's suspension, termination or failure to make payment of worker's compensation benefits is in bad faith; Section DWD 80.70, Wis. Admin. Code further defines what constitutes bad faith in a worker's compensation setting.

    - Section INS 6.11 of the Wisconsin Administrative Code provides the Commissioner of Insurance with authority to penalize insurers for bad faith violations; while the Rules do not provide insureds with a private right of action against insurance companies, violation of the Rules may be evidence of bad faith. *Heyden v. Safeco Title Ins. Co.*, 175 Wis. 2d 508, 498 N.W.2d 905 (Ct. App. 1993), *overruled on other grounds by Weiss v. United Fire and Cas. Co.*, 197 Wis. 2d 365, 541 N.W.2d 753 (1995).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

- The tort of bad faith: *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978). *See Trinity Evangelical Lutheran Church v. Tower Ins. Co.*, 2003 WI 46, 261 Wis.2d 333, 661 N.W.2d 789, *reconsideration denied*, 2003 WI 126, 265 Wis.2d 421, 668 N.W.2d 561, *cert. denied*, 540 U.S. 1074, 124 S. Ct. 925, 157 L.Ed.2d 743 (2003); *Weiss v. United Fire & Cas. Co.*, 197 Wis. 2d 365, 541 N.W.2d 753 (1995). "To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim."

    - The insured must first show the insurer did not have a reasonable basis to deny the benefits of the policy – that is, the insurer did not possess information that would lead a reasonable insurer to conclude an insured's claim is "fairly debatable." The "fairly debatable" test is an objective analysis which requires a claim to be investigated properly and the results of that investigation to be subject to reasonable evaluation and review. The reasonableness of the insurer's conduct is determined by examining the circumstances which existed when the insurer made its decision to deny benefits.

    - The insured must also show the insurer's knowledge or reckless disregard of the lack of a reasonable basis for denying then claim. This is a subjective analysis. The tort of bad faith cannot be unintentional; it is the absence of honest, intelligent action or consideration based upon knowledge of the facts and circumstances upon which a decision is predicated. There is a duty of ordinary care and reasonable diligence on the part of an insurer in handling claims, and it must be exercised with honest and informed judgment. Therefore, it is proper when applying the bad faith test to determine whether a claim was properly investigated and whether the results of the investigation were subjected to a reasonable evaluation and review. The focus for determining whether an insurer is liable for bad faith is the sufficiency or strength of its reasoning.

- As applied in bad faith failure to settle scenarios: *Hilker v. Western Auto. Ins. Co.*, 204 Wis. 1, 231 N.W. 257 (1930), *on rehearing*, 204 Wis. 12, 235 N.W. 431 (1931). *See Roehl Transport, Inc. v. Liberty Mut. Ins. Co.*, WI 2010 49, ___ N.W.2d ___, 2010 WL 2486808; *Mowry v. Badger State Mut. Cas. Co.*, 129 Wis.2d 496, 385 N.W.2d 171 (1986).

    - An insurance company owes a duty to its insured to settle or compromise a claim made against the insured and to act in good faith in doing so. The duty is analogous to that of a fiduciary, and is implied by the terms of the insurance policy that give the insurance company exclusive power to settle claims. The tort of bad faith is derived from the implied covenant of good faith and fair dealing found in every contract.

    - An insurer's decision to settle should result from the honest weighing of the probabilities of defeating the claim, and be a honest and intelligent decision based upon knowledge of the facts and circumstances upon which liability and potential damages are predicated which are obtained thorough a diligent investigation and evaluation of the underlying circumstances of the claim and on informed interaction with the insured.

- What are the applicable statutes of limitations?

    - Section 893.57, Wis. Stat. provides a two-year statute of limitations for bad faith causes of action. *Warmka v. Hartland-Cicero Mut. Ins. Co.*, 136 Wis.2d 31, 35, 400 N.W.2d 923, 925 (1987).

        - An insured's bad faith claim accrues when the insured discovers, or in the exercise of due diligence should have discovered, the injury. *Davis v. Am. Family Mut. Ins. Co.*, 212 Wis.2d 382, 391-92 569 N.W.2d 64, 68 (Ct. App. 1997).

- What defenses are available to the bad faith cause of action (e.g., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

    - Coverage for the insured's claim is "fairly debatable." *Mowry v. Badger State Mut. Cas. Co.*, 129 Wis.2d 496, 385 N.W.2d 171 (1986).

- The insurer's liability for the claim is "fairly debatable." *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978).

- The insurer has properly investigated the claim and subjected the results of the investigation to a reasonable evaluation and review. *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978).

- What are the recoverable damages for the bad faith cause of action?

  - Tort-style consequential damages:

    - *Jones v. Secura Ins. Co.*, 2002 WI 11, 249 Wis. 2d 623, 638 N.W.2d 575 (2002); *DeChant v. Monarch Life Ins. Co.*, 200 Wis. 2d 559, 547 N.W.2d 592 (1996): "[W]hen an insurer acts in bad faith by denying benefits, it is liable to the insured in tort for any damages which are the proximate result of that conduct." These damages are available even in the absence of a valid breach of contract claim, and also include "damages that were otherwise recoverable in a breach of an insurance contract claim." However, an insured "should not be able to recover duplicative damages under both a bad faith tort claim and a breach of contract claim."

  - Emotional distress damages:

    - *Jones v. Secura Ins. Co.*, 2002 WI 11, 249 Wis. 2d 623, 638 N.W.2d 575 (2002); *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978): "Recovery for emotional distress caused by an insurer's bad faith should be only allowed for severe distress, and when substantial other damage is suffered apart from the loss of contract benefits."

  - Breach of contract damages:

    - *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978). "[S]separate damages may be recovered for the tort and for the contract breach."

- Attorneys fees:

  - *Danner v. Auto-Owners Ins.*, 2001 WI 90, ¶79, 245 Wis.2d49, 629 N.W.2d159; *DeChant v. Monarch Life Ins. Co.*, 200 Wis. 2d 559, 547 N.W.2d 592 (1996); *Allied Processors, Inc. v. Western Nat'l Mut. Ins. Co.*, 2001 WI App 129, 246 Wis. 2d 579, 629 N.W.2d 329 (2001): "Attorney fees incurred in proving a bad faith claim are not awarded as attorney fees, but rather as an item of damages caused by an insurer's bad faith refusal to pay benefits owed."

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978). *See Trinity Evangelical Lutheran Church v. Tower Ins. Co.*, 2003 WI 46, 261 Wis.2d 333, 661 N.W.2d 789, *reconsideration denied*, 2003 WI 126, 265 Wis.2d 421, 668 N.W.2d 561, *cert. denied*, 540 U.S. 1074, 124 S. Ct. 925, 157 L.Ed.2d 743 (2003); Section 895.85 (3), Wis. Stat.: Proof of a bad faith claim does not necessarily make the award of punitive damages appropriate. The intent necessary to maintain an action for bad faith is distinct from what must be shown to recover punitive damages. The factors necessary for an award of punitive damages require a showing of: (1) evil intent deserving of punishment or of something in the nature of special ill-will; or (2) wanton disregard of duty; or (3) gross or outrageous conduct.

- Does the state follow the *Cumis* case (i.e., require independent counsel when there is an insurer-insured conflict)?

  - Wisconsin has not expressly adopted *Cumis*. However, the several intermediate court of appeals opinions state an insurer's reservation of rights provides the insured with the right to control the defense. *See e.g.*, *Radke v. Fireman's Fund Ins. Co.*, 217 Wis. 2d 39, 577 N.W.2d 366 (Ct. App. 1998); *Jacob v. West Bend Mut. Ins. Co.*, 203 Wis. 2d 524, 536 N.W.2d 800 (Ct. App. 1996) (the insurer may give the insured notice of the insurer's intent to reserve its coverage rights, which allows the insured the opportunity to have a defense not subject to the control of the insurer although the insurer

remains liable for the legal fees incurred). A Federal trial court has ruled an insured's right to control its defense does not necessarily encompass a right to select counsel, and only requires the insurer to pay a reasonable charge within the market for defense costs given the type of litigation and the particular geographic area. *HK Systems, Inc. v. Admiral Ins. Co.*, 2005 WL 1563340 (E.D. Wis. 2005).

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Generally, No. *Kranzush v. Badger State Mut. Cas. Co.*, 103 Wis. 2d 56, 307 N.W.2d 256 (1981): "The insurer's duty of good faith and fair dealing arises from the insurance contract and runs to the insured. No such duty can be implied in favor of the claimant from the contract since the claimant is a stranger to the contract and to the fiduciary relationship it signifies. Nor can a claimant reasonably expect there to be such a duty, inasmuch as the insurer and the insured are aligned in interest against the claimant. In the absence of any such duty, the third-party claimant cannot assert a claim for failing to settle his claim, and we therefore decline to recognize such a claim for relief under common law tort principles."

        - *But see Plautz v. Time Ins. Co.*, 189 Wis. 2d 136, 525 N.W.2d 342 (Ct. App. 1994) (an exception to this rule exists to a beneficiary's right to sue an insurer for benefits due under a life insurance policy when the insured owner of the policy has passed away).

WYOMING

SUMMARY:

- Can insureds sue for bad faith (i.e., first party bad faith)? Yes. *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855 (Wyo. 1990).

- Can third parties sue for bad faith (i.e., third party bad faith)? No.

FIRST PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. Wyoming has adopted an Unfair Claims Settlement Practices Act. Wyo. Stat. §26-13-124. It does not create a private right of action. *Herrig v. Herrig*, 844 P.2d 487, 494 (Wyo. 1992): "The Wyoming Insurance Code, Wyo. Stat. §§ 26-1-101 to 26-44-117 (1991 & Supp. 1992), is a comprehensive enactment for the regulation of the insurance industry. The insurance commissioner is charged with the responsibility of enforcing the provisions of the Code. Section 26-2-109(a)(iii). In order to carry out this responsibility, the insurance commissioner is granted broad rule making, investigatory, and enforcement authority. *See generally* §§ 26-2-101 to -130. Absent an express provision to the contrary, we do not believe that the Wyoming Legislature intended for the Code to also be enforced by private action. Accordingly, we hold that no implied private right of action exists under § 26-13-124 of the Wyoming Insurance Code."

    - Accord: *Julian v. New Hampshire Insurance Company,* 694 F.Supp. 1530 (D. Wyo. 1988).

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - Yes. *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855 (Wyo. 1990). "We believe the appropriate test to determine bad faith is the

objective standard whether the validity of the denied claim was not fairly debatable. . . . 'To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. It is apparent, then, that the tort of bad faith is an intentional one.'" *Id.* at 860.

- The validity of a claim is fairly debatable if a reasonable insurer would have denied or delayed payment of benefits under the facts and circumstances. *Gainsco Ins. Co. v. Amoco Production Co.*, 53 P.3d 1051, 1058 (Wyo. 2002).

- However, a breach of a specific term of the policy is not required and bad faith may exist in handling the claim even where the claim is "fairly debatable." *Hatch v. State Farm Fire & Cas. Co.*, 842 P.2d 1089 (Wyo. 1992). The cause of action exists but the standard to be applied is confused and unsettled.

- A cause of action for bad faith will lie when a liability insurer fails in bad faith to settle a third-party claim within policy limits against its insured. Bad faith in this context would occur if an excess judgment were obtained under circumstances when the insurer failed "to exercise intelligence, good faith, and honest and conscientious fidelity to the common interest of the [insured] as well as of the [insurer] and [to] give at least equal consideration to the interest of the insured." *Herrig v. Herrig*, 844 P.2d 487, 490 (Wyo. 1992) (citing *Western Casualty and Surety Company v. Fowler*, 390 P.2d 602 (Wyo. 1964)).

- An action for bad faith will also lie when an insurer fails to inform its insured of first-party policy benefits where the insured brings a third-party liability claim against another of the insurer's insureds and "it is apparent to the insurer that (1) there is a strong likelihood that its insured only can be compensated fully under her own policy and (2) the insured has no basis to believe that [she] must rely upon [her] policy for coverage." *Herrig v. Herrig*, 844 P.2d 487, 491 (Wyo. 1992) (citing *Darlow v. Farmers Insurance Exchange*, 822 P.2d 820, 828 (Wyo. 1991)).

- What are the applicable statutes of limitations?

- Wyo. Stat. § 1-3-105 (10 years on written contract, 4 years for injury to rights not arising on contract, 1 year on a statute for penalty or forfeiture).

- What defenses are available to the bad faith cause of action (e.g.., the "genuine dispute of fact" doctrine; "wrong but reasonable")?

  - The law regarding defenses unique to claims of bad faith is unsettled. However, as noted above, it is not bad faith to deny a claim that is fairly debatable. *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855 (Wyo. 1990).

- What are the recoverable damages for the bad faith cause of action?

  - General damages for both breach of contract and tort. *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855 (Wyo. 1990).

  - Attorneys' Fees under Wyo. Stat. §26-15-124(c) are also possible. It provides:

    (c) In any actions or proceedings commenced against any insurance company on any insurance policy or certificate of any type or kind of insurance, or in any case where an insurer is obligated by a liability insurance policy to defend any suit or claim or pay any judgment on behalf of a named insured, if it is determined that the company refuses to pay the full amount of a loss covered by the policy and that the refusal is unreasonable or without cause, any court in which judgment is rendered for a claimant may also award a reasonable sum as an attorney's fee and interest at ten percent (10%) per year.

    See Herrig v. Herrig, 844 P.2d 487, 494-95 (Wyo. 1992) (this section may apply even if the insurer ultimately pays the loss).

- Are punitive damages recoverable? If so, what is the standard that must be met to recover them?

  - Yes. The standard is willful and wanton conduct. *McCullough v. Golden Rule Ins. Co.* 789 P.2d 855, 860-61 (Wyo. 1990).

- Are punitive damages insurable?

    - Yes, punitive damages are insurable. It is not against Wyoming public policy to insure against either liability for punitive damages imposed vicariously based on willful and wanton misconduct or for personal liability for punitive damages imposed on basis of willful and wanton misconduct. *Sinclair Oil Corp. v. Columbia Cas. Co.*, 682 P.2d 975 (Wyo. 1984).

- Can punitive damages assessed against the insured after the insurer fails to settle be recovered by the insured from the insurer as damages for bad faith failure to settle?

    - No case has decided this issue. However, as punitive damages can be insurable, it may follow that an excess judgment can include them.

- Can an insurer be held liable for the malpractice of its appointed defense counsel?

    - Unclear. *International Surplus Lines Ins. Co. v. Univ. of WY Research Corp.*, 850 F.Supp. 1509 (D. Wyo. 1994), dealt with the issue of whether the insurer could be liable for bad faith for the conduct of its counsel in the coverage litigation with the insured. After reviewing the standards set by *Hatch v. State Farm Fire & Cas. Co.*, 842 P.2d 1089 (Wyo. 1992), the court held that for claims alleging litigation misconduct there are various remedies available under the Federal Rules of Civil Procedure. The Court also relied on the Wyoming Supreme Court's ruling in *Allen v. Safeway Stores, Inc.*, 699 P.2d 277, 282-84 (Wyo. 1985), to hold that "court-imposed remedies may be necessary in certain circumstances, they are an unwarranted exercise of the judicial prerogative when other avenues of redress, exist." 850 F.Supp. at 1529. The District Court stated that claims of this type are not even directed at the insurer per se, but are directed at counsel for the insurer. *Id.* at 1529. "Aside from the fact that the purpose of the covenant of good faith and fair dealing, namely, deterrence of these claims practices by insurers and their adjusters, would not be furthered by applying it to *counsel* for the insurer, it is clear that such an unwarranted imposition of liability might have a chilling effect on insurers,

which could unfairly penalize them by inhibiting their attorneys from zealously and effectively representing their clients within the bounds permitted by law." *Id.*

THIRD PARTY BAD FAITH:

- Are there statutory grounds for the bad faith cause of action? If so, identify the source (i.e., an Unfair Claims Practices Act, or some other consumer protection statute) and its main provisions.

    - No. *Herrig v. Herrig*, 844 P.2d 487, 494 (Wyo. 1992): "The Wyoming Insurance Code, Wyo. Stat. §§ 26-1-101 to 26-44-117 (1991 & Supp. 1992), is a comprehensive enactment for the regulation of the insurance industry. The insurance commissioner is charged with the responsibility of enforcing the provisions of the Code. Section 26-2-109(a)(iii). In order to carry out this responsibility, the insurance commissioner is granted broad rule making, investigatory, and enforcement authority. *See generally* §§ 26-2-101 to -130. Absent an express provision to the contrary, we do not believe that the Wyoming Legislature intended for the Code to also be enforced by private action. Accordingly, we hold that no implied private right of action exists under § 26-13-124 of the Wyoming Insurance Code."

    - Accord: *Julian v. New Hampshire Insurance Company*, 694 F.Supp. 1530 (D. Wyo. 1988).

    - However, there is a possible claim by a third party claimant for attorney's fees under Wyo. Stat. §26-15-124(c) which provides:

      (c) In any actions or proceedings commenced against any insurance company on any insurance policy or certificate of any type or kind of insurance, or in any case where an insurer is obligated by a liability insurance policy to defend any suit or claim or pay any judgment on behalf of a named insured, if it is determined that the company refuses to pay the full amount of a loss covered by the policy and that the refusal is unreasonable or without cause, any court in which judgment is rendered for a claimant may also award a reasonable sum as an attorney's fee and interest at ten percent (10%) per year.

In *Herrig v. Herrig*, 844 P.2d 487, 494 (Wyo. 1992), the court held: "[W]e interpret subsection (c), the only subsection arguably applicable to third-party claimants, to provide that a court may award attorney's fees and interest under very limited circumstances. Those circumstances are when: (1) the third-party claimant has reduced his liability claim against an insured to judgment or has reached a settlement agreement with the insured and insurer; (2) the insurer subsequently has refused to pay the judgment or the settlement amount to the extent covered by the policy; and (3) the refusal to pay has been determined to be unreasonable or without cause in an action to collect on the judgment or to enforce the settlement agreement.

- The Wyoming Supreme Court expounded further on Wyo. Stat. §26-15-124(c) in *Stewart Title Guaranty Co. v. Tilden*, 100 P.3d 865 (Wyo. 2005). It held that the section provided a stand alone private right of action which was not conditioned on the claimant having suffered actual injury. (In this case the insurer had cured a title defect but its delayed unreasonably in doing so.) It stated:

  > In sum, the construction of § 26-15-124(c) as determined by this Court is that § 26-15-124(c) creates a private right of action. Under the present circumstances, the claim brought under the statute requires the following elements be proven: 1) an action or proceeding was commenced (which could include the present action); 2) against the insurance company; 3) on any insurance policy or any type or kind of insurance; 4) that in that action or proceeding it was determined that the company refused to pay the full amount of loss covered by the policy or otherwise fulfill its obligations to the insured under the policy; 5) and that a determination was made in that action or proceeding that the refusal was unreasonable or without cause. A court that renders a judgment finding these elements have been satisfied may award a reasonable sum as an attorney's fee and interest at 10% per year as damages. Any other reading would render various words or clauses of the statute meaningless. *Id.* at 873.

- Is there a common law/judicially created bad faith cause of action (i.e., the implied covenant of good faith)? If so, identify the major case(s) and language of the standards applicable to bad faith cases.

    - No. *Herrig v. Herrig*, 844 P.2d 487, 491-92 (Wyo. 1992): "We are persuaded that no basis is present for extending an insurers' duty of good faith and fair dealing to third-party claimants, even in the context of intra-family suits. To extend the duty would only compromise the insurer's ability to protect its own interests and those of its insured."