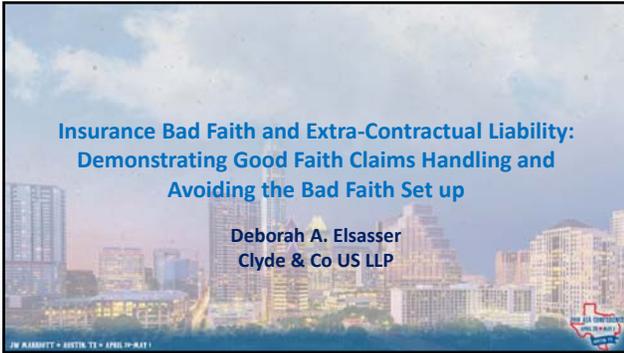


**Insurance Bad Faith and Extra-Contractual Liability:
Demonstrating Good Faith Claims Handling and
Avoiding the Bad Faith Set up**

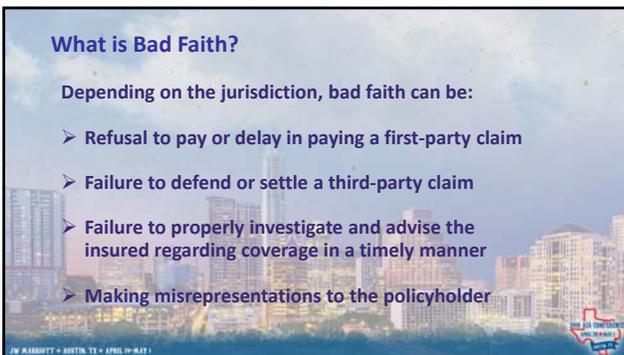
Deborah A. Elsasser
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What is Bad Faith?

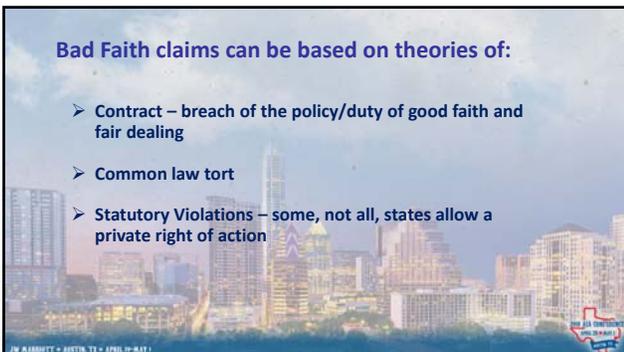
Depending on the jurisdiction, bad faith can be:

- Refusal to pay or delay in paying a first-party claim
- Failure to defend or settle a third-party claim
- Failure to properly investigate and advise the insured regarding coverage in a timely manner
- Making misrepresentations to the policyholder



Bad Faith claims can be based on theories of:

- Contract – breach of the policy/duty of good faith and fair dealing
- Common law tort
- Statutory Violations – some, not all, states allow a private right of action



Nature of claim and recoverable damages varies by jurisdiction

States have differing rules regarding:

- The insured's right to claim bad faith
- The damages recoverable
- The nature of conduct that constitutes bad faith



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Damages recoverable for first-party bad faith claims may include (depending on the jurisdiction):

- Consequential damages that are within the contemplation of the parties
- Emotional distress damages
- Attorneys' fees
- Punitive damages (level of required conduct differs by state)



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Damages recoverable for third-party bad faith claims may include (depending on the jurisdiction):

- Damages to the claimant in excess of policy limits
- Attorneys' fees
- Punitive Damages
- Emotional distress damages



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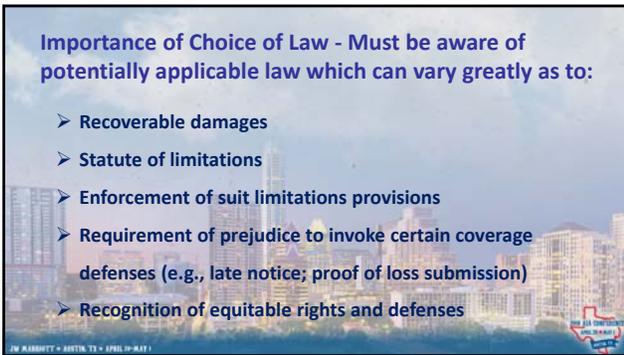
Importance of Choice of Law - Must be aware of potentially applicable law which can vary greatly as to:

- Time periods to respond to insured
- Effectively reserving rights or disclaiming coverage
- Insured's right to independent counsel
- Conduct giving rise to bad faith claim
- Insured's right to settle without consent of insurer



Importance of Choice of Law - Must be aware of potentially applicable law which can vary greatly as to:

- Recoverable damages
- Statute of limitations
- Enforcement of suit limitations provisions
- Requirement of prejudice to invoke certain coverage defenses (e.g., late notice; proof of loss submission)
- Recognition of equitable rights and defenses



First-Party Claims Handling Practices

Nearly all states have statutory or regulatory scheme governing fair claims handling

Most states have adopted the Unfair Claims Settlement Practices Act (UCSPA or Model Act)

Do not assume requirements are uniform – particularly with regard to time periods

States are split on whether provides a private right of action

Unfair business practices claims also allowed in some jurisdictions under state unfair business practices/competition laws



First-Party Claims Handling Practices

- Be aware of particular states' deadlines/timetable for initial and follow-up responses
- Clock starts ticking when insurer receives the claim
- Demonstrate good faith: Pay covered claims promptly
- Reserve rights on disputed items
- Conduct timely, objective and reasonable investigation into facts (refrain from requesting information not material to the claim)
- Investigate applicable statutes/ordinances that may apply to claim and impact coverage (e.g. hurricane/storm claims)

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First-Party Claims Handling Practices

- Make prompt coverage determination after receipt of information and conclusion of investigation
- Think before you type – internal memos/emails could become discoverable and must demonstrate that claim was handled in accordance with statute and company's guidelines
- Make sure internal communications do not conflict with communications with insured
- File should contain all evidence gathered in investigation, records of communications and clear explanation of basis for payment or denial of claim(s)
- Keep the insured informed throughout the claim handling process

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First-Party Claims Handling Practices – Notable Decisions – Reasonable Basis for Denial

Rankosky v. Washington National Insurance, 170 A.3d 364 (Pa. 2017)
 Mere negligence cannot amount to bad faith; insured must prove by clear and convincing evidence that insurer lacked a reasonable basis for denying of benefits and knew of or recklessly disregarded its lack of a reasonable basis. In *dicta*, court stated that punitive damages can be awarded on standard less than willful and wanton conduct normally required for imposition of punitive damages.

Home Loan Inv. Co. v. St. Paul Mercury Ins. Co., 2016 WL 3610054 (10th Cir. July 5, 2016)
 Fairly debatable coverage issue is not sufficient standing alone to defeat a bad faith claim.

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First-Party Claims Handling Practices – Notable Decision

USAA Tex. Lloyds Co. v. Menchaca, 2018 Tex. LEXIS 313 (Texas April 13, 2018)

Insured cannot recover policy benefits as damages for a statutory violation if the policy does not provide the insured a right to receive those benefits. An insurer cannot be liable for failing to settle or investigate a claim that it has no contractual duty to pay. However, the insured may recover damages if an insurer's statutory violation causes an injury independent of a right to benefits.

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First-Party Claims Handling Practices – Insurer's Litigation Conduct

Berg v. Nationwide Mutual Ins. Co., 2018 Pa. Super. LEXIS 317 (Pa. Super. Ct. April 9, 2018)

\$21M bad faith award reversed because trial court's "highly selective citation" to record evidence failed to meet clear and convincing standard of proof for bad faith – trial court also erred in using the length of the bad faith/coverage litigation or discovery violations as evidence of bad faith

But see Hicks v. Progressive Casualty Ins. Co., 2017 WL 1208599 (9th Cir. Apr. 3, 2017): litigation tactics can be used as to show bias and bad faith.

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First-Party Claims Handling Practices – Conduct of Investigation

Hicks v. Progressive Casualty Ins. Co., 2017 WL 1208599 (9th Cir. Apr. 3, 2017)

An insurer must give at least as much consideration to the interests of the insured as it gives to its own interests. While the insurer has no obligation . . . to pay every claim its insured makes, the insurer cannot deny the claim without fully investigating the grounds for its denial. [D]enial of a claim on a basis unfounded in the facts known to the insurer, or contradicted by those facts, may be deemed unreasonable. The insurer may not just focus on those facts which justify denial of the claim.

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First-Party Claims Handling Practices – Conduct of Investigation

Progressive performed an inadequate and biased investigation into the accident—one that was designed to protect its own interests without any regard for Hicks's interests. Progressive immediately formed an opinion that Hicks's injury was caused by an earlier accident and never seriously considered any other possibility.

The "genuine dispute" doctrine does not apply here "where the evidence shows 'the insurer dishonestly selected its experts[,] the insurer's experts were unreasonable[,] [or] the insurer failed to conduct a thorough investigation.'" Throughout its investigation, Progressive sought to portray Hicks and his mother as liars. ...This is evidence of Progressive's bias towards its insured.

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First-Party Claims Handling Practices – Conduct of Investigation

Charles A. Shadid LLC v. Aspen Specialty Ins. Co., (W.D. Ok. Feb. 14, 2018)

Court denied insurer's motion for summary judgment finding issue of fact as to whether insurer conducted a timely investigation and assessment of insured's property damage where insured failed to provide information regarding prior claims and condition of the properties and insurer denied coverage for failure to cooperate and failure to establish a covered loss during the policy period.

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First-Party Claims Handling Practices – Conduct of Investigation

Saddleback Inn, LLC v. Certain Underwriters at Lloyd's London, 2017 WL 1180419 (Cal. Ct. App. Mar. 30, 2017)

Insurer engaged in bad faith when it conducted an incomplete and "non-objective investigation" into fire loss notwithstanding that it ultimately paid the claim.

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Third-Party Claims Handling Practices – Duty to Defend

- Broader than duty to indemnify
- Bare possibility of coverage
- Four or Eight Corners Rule vs. Consideration of extrinsic facts
- Defend under a reservation of rights to avoid waiver of coverage defenses
- Conduct investigation into coverage issues but make prompt determination of coverage and keep insured informed
- Different states have different rules regarding time to respond to tender/time to disclaim coverage/content of disclaimer and ROR letters

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**Third-Party Claims Handling Practices
Duty to Defend**

- Right to independent “Cumis” counsel differs by state but majority rule is that there is no right to independent counsel unless reservation of rights creates an actual conflict of interest (i.e. when the facts to be adjudicated in the liability action are the same facts that determine coverage) *San Diego Fed. Credit Union v. Cumis Ins. Soc’y*, 162 Cal App 3d 348 (Cal. Ct. App. 1984); Cal. Civil Code Section 2860
- Exception to this rule: Alaska (broad duty to provide independent counsel unless insured waives the right in writing)
- Certain states allow insured the right to reject the defense and retain its own counsel without jeopardizing coverage and in most cases at insurer’s expense or subject to reimbursement by insurer (Florida, NJ, Michigan, Missouri, Kentucky)

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Third-Party Claims Handling Practices – Duty to investigate and promptly resolve coverage issues

Courts have allowed bad faith claims notwithstanding a finding of no coverage or where the insurer defended and ultimately indemnified the insured, based on insurer’s failure to adequately or promptly investigate or inform the insured

Usually an issue of fact for jury to decide

Some states place burden on insurer to commence a declaratory judgment action to determine coverage early on (but not always feasible where underlying facts not developed)

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Third-Party Claims Handling Practices – Duty to investigate and promptly resolve coverage issues

Advantage Bldgs & Exteriors, Inc. v. Mid-Continent Cas. Co., 449 S.W.3d 16 (Mo. App. 2014)
Insurer defended construction defects case under ROR; failed to settle claim at mediation for \$1M policy limits; 5 days before trial filed a DJ action and informed insured for first time that coverage not available for majority of \$3M claim; DJ resulted in finding of no coverage but court permitted bad faith claim and jury rendered verdict of \$3M for uncovered claim plus \$2M punitives. Court found that insurer's ROR was vague and insurer failed to promptly advise insured of its coverage position.

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Third-Party Claims Handling Practices – Duty to investigate and promptly resolve coverage issues

Travelers Property Cas. Co. of America v. Fed. Recovery Svcs., 156 F. Supp. 3d 1330 (D. Utah 2016): Court found no coverage under cyber liability E & O policy, no duty to defend and no breach of contract, however, court allowed claim for breach of implied duty of good faith and fair dealing based on alleged inadequate investigation of the claim and failure to promptly and reasonably communicate with the insured.

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Third-Party Claims Handling Practices - Duty to Settle

Duty to respond to time-limited policy limits demand vs. duty to affirmatively attempt to settle claims

Negligent failure to settle as basis for bad faith

Time Limited Settlement Demands

Insurers' duty when liability is doubtful or unknown
Striegel v. Am. Fam. Mut. Ins. Co., 2015 WL 4113178 (D. Nev. July 7, 2015)(two-week per person policy limit demand unreasonable given number of claims and lack of medical information)

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Third-Party Claims Handling Practices - Duty to Settle

Can Insured settle case when insurer defending under ROR?

Breach of policy condition requiring consent of insurer?

Depends on the jurisdiction



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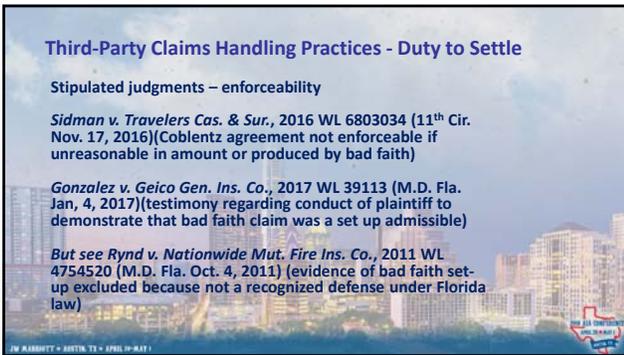
Third-Party Claims Handling Practices - Duty to Settle

Stipulated judgments – enforceability

Sidman v. Travelers Cas. & Sur., 2016 WL 6803034 (11th Cir. Nov. 17, 2016)(Coblentz agreement not enforceable if unreasonable in amount or produced by bad faith)

Gonzalez v. Geico Gen. Ins. Co., 2017 WL 39113 (M.D. Fla. Jan. 4, 2017)(testimony regarding conduct of plaintiff to demonstrate that bad faith claim was a set up admissible)

But see Rynd v. Nationwide Mut. Fire Ins. Co., 2011 WL 4754520 (M.D. Fla. Oct. 4, 2011) (evidence of bad faith set-up excluded because not a recognized defense under Florida law)



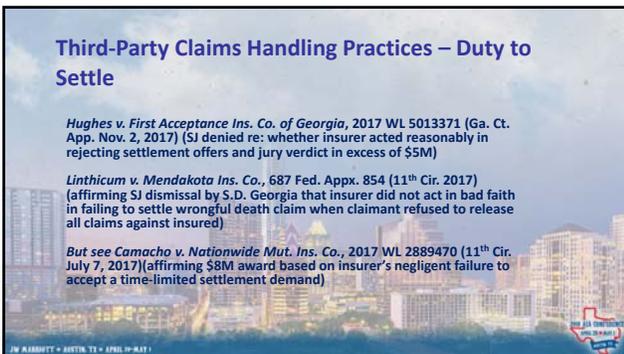
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Third-Party Claims Handling Practices – Duty to Settle

Hughes v. First Acceptance Ins. Co. of Georgia, 2017 WL 5013371 (Ga. Ct. App. Nov. 2, 2017) (SJ denied re: whether insurer acted reasonably in rejecting settlement offers and jury verdict in excess of \$5M)

Linthicum v. Mendakota Ins. Co., 687 Fed. Appx. 854 (11th Cir. 2017) (affirming SJ dismissal by S.D. Georgia that insurer did not act in bad faith in failing to settle wrongful death claim when claimant refused to release all claims against insured)

But see Camacho v. Nationwide Mut. Ins. Co., 2017 WL 2889470 (11th Cir. July 7, 2017)(affirming \$8M award based on insurer's negligent failure to accept a time-limited settlement demand)



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Potential Third-Party Bad Faith Pitfalls:
Inadequate Limits for number of claims or number of insureds

- Creates challenges to settlement
- Can lead to bad faith allegations where coverage exhausted by settlement of less than all claims or on behalf of less than all insureds
- Different states have different rules as to insurer's obligation to settle claims with inadequate limits

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Potential Third-Party Bad Faith Pitfalls:
Inadequate Limits for number of claims or number of insureds

Majority Rule: Insurer is permitted in good faith to settle less than all claims for policy limits

- Texas: Insurer must meet its Stowers obligation and act reasonably but may settle less than all claims for policy limits. *Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312 (Tex. 1994); *Travelers Indem. Co. v. Citgo Petroleum Corp.*, 166 F.3d 761 (5th Cir. 1999); but see *American Western Home Ins. Co. v. Tristar Convenience Stores, Inc.*, 2011 U.S. Dist. LEXIS 59911 (S.D. Tex. June 2, 2011) [question of fact existed as to whether insurer acted reasonably in paying policy limits to settle for 2 insureds after previously rejecting a policy limits demand for all 4 insureds]
- New York: *World Trade Center Properties LLC*, 650 F.3d 145 (2d Cir. 2011) (insurer may settle whenever and with whomever it chooses, provided it does not act in bad faith)
- Florida: Insurer must act in good faith and attempt to settle as many claims as possible within limits but may settle less than all claims. *Parinos v. Florida Farm Bureau Gen. Ins. Co.*, 850 So. 2d 555 (Fla. Dist. Ct. App. 2003)
- Pennsylvania: Insurer can accept reasonable settlement offer releasing less than all insureds. *Anglo-American Ins. Co. v. Lawrence*, 670 A.2d 194 (Pa. Commw. Ct. 1995)

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Potential Third-Party Bad Faith Pitfalls:
Inadequate Limits for number of claims or number of insureds

Pro Rata Rule: Insurer must allocate limits to multiple claims on pro rata basis

- Missouri: *Christleib v. Luten*, 633 S.W.2d 139 (Mo. Ct. App. 1982)

Interpleader Rule: Insurer must file interpleader action and pay limits into court.

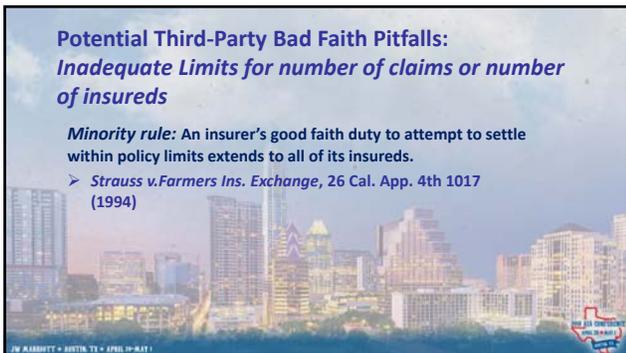
- Kansas: *Farmers Ins. Exchange v. Schropp*, 222 Kansas 612 (1977)

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Potential Third-Party Bad Faith Pitfalls:
Inadequate Limits for number of claims or number of insureds

Minority rule: An insurer's good faith duty to attempt to settle within policy limits extends to all of its insureds.

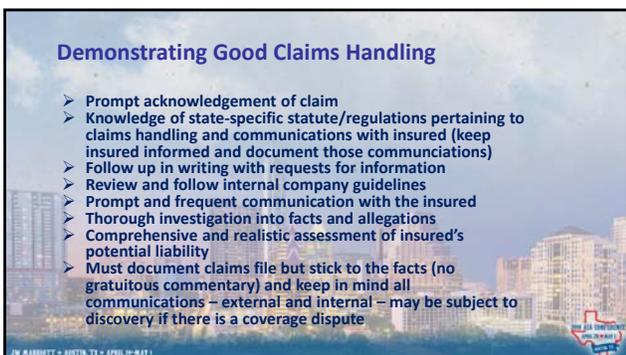
- *Strauss v. Farmers Ins. Exchange*, 26 Cal. App. 4th 1017 (1994)



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Demonstrating Good Claims Handling

- Prompt acknowledgement of claim
- Knowledge of state-specific statute/regulations pertaining to claims handling and communications with insured (keep insured informed and document those communications)
- Follow up in writing with requests for information
- Review and follow internal company guidelines
- Prompt and frequent communication with the insured
- Thorough investigation into facts and allegations
- Comprehensive and realistic assessment of insured's potential liability
- Must document claims file but stick to the facts (no gratuitous commentary) and keep in mind all communications – external and internal – may be subject to discovery if there is a coverage dispute



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Avoiding Pitfalls

- Conduct thorough investigation before making coverage determination
- Consider retaining outside coverage counsel in interested jurisdiction
- Retain adjuster to investigate claim
- Timely notify insured of any potential coverage issues and properly reserve rights
- Fully evaluate (and anticipate) settlement demands
- Solicit advice as to insured's liability/damages exposure from counsel in interested jurisdiction
- Be proactive not reactive!



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