

BAD FAITH

TRENDS IN STATUTORY AND COMMON LAW FRAMEWORK AND REVIEW OF RECENT CASES

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I. INTRODUCTION

The term "bad faith" in the context of insurance law is a bit of a misnomer. Although initially a reference to malfeasance, the term in current parlance encompasses a wide and not always well-defined scope of insurer misconduct. The law of bad faith has evolved and continues to evolve as a patchwork of common law and statutory precepts, with significant variation of approach among and even within different jurisdictions.

Courts and legislatures developed the concept of recovery for bad faith to address the imbalance of resources and control between insurers and insureds. In theory, the threat of extra-contractual damages for bad faith acts is to serve as a Sword of Damocles, precariously placed above the heads of insurance companies to remind them of their duty of fair dealings and the expeditious handling of claims. However, due to the inconsistent standards employed by the states, the amorphous, expanding scope of "unfair claims practices," and the role of juries in determining whether an insurer has acted "unreasonably," the threat of bad faith to the insurer may seem more akin to a minefield than a finely-honed blade.

As there is no dearth of case law and commentary concerned with the many facets of the law of bad faith, this article will focus upon issues most germane to those who are concerned with fidelity insurance and related contracts of first-party insurance. The article and appended chart are intended to provide a reference tool of particular interest to the fidelity insurers, which

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may be consulted in concert with more comprehensive works and previous compilations.¹

II. HISTORICAL UNDERPINNINGS

During the first part of this century, the advent of automobile insurance and the development of other personal lines insurance products led to an increasing number of suits against liability insurers for damages resulting from inequitable claims settlement practices. These suits typically involved an insurer's unreasonable refusal to settle within policy limits, followed by a judgment against the insured for an amount in excess of the limits of liability. It was this type of inequity that led to the development of the current common law and statutory actions for bad faith.

A. *The Movement from Contract to Tort*

Although contractual responsibilities have long been recognized to include an implied obligation of good faith and fair dealing,² an action in contract for breach of this obligation would not provide an adequate remedy to the insured. Under principles of contract law first enunciated in *Hadley v. Baxendale*,³ damages are recoverable only for those injuries that the insurer had reason to foresee as a probable result of his breach at the time the contract was entered into:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally; i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as a probable result of the breach.⁴

¹ See generally STEPHEN S. ASHLEY, *BAD FAITH ACTIONS, LIABILITY & DAMAGES* (2d ed. 1997); Douglas R. Richmond, *An Overview of Insurance Bad Faith and Litigation*, 25 SETON HALL L. REV. 74 (1994); Daniel S. Bopp, *Tort and Contract in Bad Faith Cases: Is The Honeymoon Over?*, 59 DEF. COUNS. J. 524 (1992); Annot., 33 A.L.R. 4th 579 (1981); and as to fidelity insurance specifically, see Peter C. Haley & Brandt L. Wolkin, *Bad Faith and the Financial Institution Bond*, 25 TORT & INS. L.J. 715 (1990).

² The legal obligation of "good faith and fair dealing" dates back to the law of the Roman Empire, and some of the earliest known legal treatises. 3A ARTHUR L. CORBIN, *CORBIN ON CONTRACTS* § 654A (1960 & Supp. 1980). However, the position that this obligation is inherent in all contracts is relatively new. See *RESTATEMENT (SECOND) OF CONTRACTS* § 205 (1981) and U.C.C. § 1-203 (1977).

³ 156 Eng. Rep. 145 (Ex. 1854).

⁴ *Id.* at 146. Note that foreseeability is still requirement for the test of proximate cause and remoteness under contract law. See COLLITON ON CONTRACTS, Chapter 56, § 1006 *et seq.*, and *RESTATEMENT (SECOND) OF CONTRACTS* § 351 (1981).

Under the foregoing principle, the only damages foreseeable to the insurer at the time of the policy's issuance would be the limit of liability. Consequently, even where an insurer's wrongful refusal to settle within policy limits resulted in a judgment against the insured for an amount in excess of the limits of liability, courts found that the insurer could only be liable in contract for damages up to the policy's limits. The breach of contract theory would not allow the insured to recoup the loss in excess of limits from the insurer.⁵

In time, courts allowed disgruntled insureds to maintain a cause of action for inequitable claims settlement practices under traditional tort theories of negligence and fraud.⁶ Because of the difficulty of establishing a claim for fraud, insureds would commonly opt to style such suits as seeking damages for negligence and breach of good faith. Although the duty of good faith and fair dealing was already recognized as implicit in the contractual relationship, courts began to articulate other equitable principles as the basis for imposing such a duty upon the insurer, including the unequal bargaining power of the insurer and insured, the control of the insurer in the drafting process, and the unique role of the insurer as a fiduciary of the insured with an interest often adverse to the insured. As courts expanded the rationale for imposing the duty of good faith and fair dealing upon insurers, they began to extend the liability of the insurer beyond the contract.⁷ After several decades, there appeared to be little difference between an action for negligence or an action for bad faith.⁸

Eventually, a court expressly recognized that an action for bad faith could be based either in tort or in contract. In *Comunale v. Traders & General Insurance Co.*⁹ the California Supreme Court reiterated the maxim that an implied covenant of good faith and fair dealing exists between parties to every contract and that neither party is to act so as to injure the right of the other to receive the benefits of the agreement. For breach of the covenant, however, the court ruled that an insured could pursue its insurer in either contract or tort.¹⁰

Thereafter, in *Crisci v. Security Insurance Co. of New Haven, Connecticut*¹¹ the California Supreme Court expanded upon *Comunale* by articulating further the scope of the insurer's duty to settle suits against its insured by

⁵ See CORBIN, *supra* note 2; ASHLEY, *supra* note 1, § 2:02.

⁶ ASHLEY, *supra* note 1, § 2:03.

⁷ See *Brassil v. Maryland Cas. Co.*, 210 N.Y. 235, 104 N.E. 622 (1915).

⁸ See *Hilker v. Western Auto Ins. Co.*, 204 Wis. 12, 235 N.W. 413 (1931).

⁹ 328 P.2d 198 (Cal. 1958).

¹⁰ *Id.* at 200.

¹¹ 426 P.2d 173 (Cal. 1967).

third parties. The court ruled that an insurer meets its duty to accept reasonable settlements only when the interests of the insured are given as much consideration as the interests of the insurer. This should be determined by considering whether a prudent insurer without policy limits would have accepted the settlement offer. The court further clarified that, to maintain a cause of action for bad faith, an insurer would not need to prove dishonesty, fraud or concealment on the part of the insurer.¹²

B. The Extension of Bad Faith to First-Party Cases

In the context of a first-party claim, the concerns addressed by cases like *Comunale* and *Crisci* are not so prevalent. Most significantly, since first-party insurance is not intended to protect an insured from liability to third parties, the risk of insurer settlement of third-party claims without regard to the insured's interests does not exist. Moreover, in the specific case of fidelity insurance, which is primarily sold to financial institutions and secondarily to commercial entities, it is often the case that there is little difference between the sophistication or financial wherewithal of the insured and insurer. Nevertheless, the tort of bad faith is now available to first-party insureds in a majority of jurisdictions in the United States, and fidelity insurers, although exempted from claims handling statutes in many states, are lumped together with third-party insurers and first-party insurers that provide policies to individual members of the public.¹³

The tort of bad faith in first-party insurance cases was first recognized in *Gruenberg v. Aetna Insurance Company*.¹⁴ In relying upon an appellate decision,¹⁵ the court expanded upon its earlier decisions in *Comunale* and *Crisci*:

In those two cases [*Comunale* and *Crisci*], we consider the duty of the insurer to act in good faith and fairly in handling the claims of third persons against the insured, described as a "duty to accept reasonable settlements," In the case before us we consider the duty of an insurer to act in good faith and fairly in handling the claim of an insured, namely a duty not to withhold unreasonably payments due under a policy. These are merely two different aspects of the same duty... [if the insurer] fails to deal fairly and in good faith with its insured by refusing, without proper cause, to compensate its insured for loss covered by the policy, such conduct may give rise

¹² *Id.*

¹³ See *infra* Appendix A, "Statutory and Common Law Approach to Bad Faith" for a list of jurisdictions that have adopted the tort of bad faith as to first-party insurance, and a list of jurisdictions in which fidelity insurers are exempted from claims-handling statutes.

¹⁴ 510 P.2d 1032 (Cal. 1973).

¹⁵ *Fletcher v. Western Nat'l Life Ins. Co.*, 89 Cal. Rptr. 78 (Cal. 1970).

to a cause of action tort for breach of an implied covenant of good faith and fair dealing.¹⁶

Under *Gruenberg* a first-party insurer may be liable in bad faith for (1) failing to act fairly and in good faith in discharging its contractual responsibilities; (2) refusing to honor a covered loss without proper cause; and (3) unreasonably withholding payments due under a policy.

Gruenberg is troubling for first-party insurers on several levels. First, the ruling defines the tort of bad faith in general terms that invite an insured to add a bad faith count to virtually any coverage action. Moreover, because the *Gruenberg* standard incorporates a test of what is "reasonable" or "proper," it largely shifts the consideration of bad faith to the jury. Thus, *Gruenberg* increases the frequency and cost of bad faith litigation and decreases the predictability of the outcome.

Fortunately for first-party insurers, *Gruenberg* was not the last word on the proper standard for the tort of bad faith in first-party cases. A narrower standard, which has been widely adopted in other jurisdictions, was promulgated by the Wisconsin Supreme Court in *Anderson v. Continental Insurance Company*.¹⁷ In *Anderson*, the Wisconsin Supreme Court adopted the general reasoning of *Gruenberg* but set forth the following elements for the cause of action: "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 or the lack of reasonable basis for denying the claim."¹⁸

The court in *Anderson* held that the tort of bad faith is an intentional tort based upon an objective standard of whether a reasonable insurer under the circumstances would have denied or delayed payment of the claim. The court further held that an insurance company is not necessarily liable for bad faith by denying payment based upon reasoning that may prove to be incorrect. To the contrary, an insurer could be expected to challenge claims which are "fairly debatable."

Currently, a majority of states will allow an insured to seek damages in tort for first-party insurer bad faith. Of these states most apply the *Anderson* standard or similarly require an element of ill intent. Nevertheless, a substantial number of jurisdictions have adopted the more liberal *Gruenberg* analysis.¹⁹ At this time it is impossible to predict whether courts in any particular jurisdiction will move closer to *Anderson* or *Gruenberg*, but it is virtually

¹⁶ *Gruenberg*, 510 P.2d at 1039-40.

¹⁷ 217 N.W.2d 368 (Wis. 1978).

¹⁸ *Id.*

¹⁹ See *infra*, Appendix A, "Statutory and Common Law Approach to Bad Faith."

certain that courts will be requested to move in both directions by advocates for insureds and insurers, according to their interests.

C. The Development of Statutory Bad Faith

Concern about the perceived inequity between insurers and insureds has not been confined to the courts. The legislatures of every state have enacted statutes or regulations or both to prohibit unfair insurance trade and claims practices.

1. Unfair Claims Practices Act

In *United States v. South-Eastern Underwriters Association*,²⁰ the United States Supreme Court, reversing an earlier decision, held that insurance was commerce and thus subject to federal regulation under the Commerce Clause. Until that time, insurance policies were characterized as contracts of indemnity subject only to state, not federal, authority.²¹ Due in part to the conflict between the federal and state approaches to insurance regulation, Congress passed the McCarran-Ferguson Act²² which established a three-year moratorium²³ after which federal regulators would be free to assert their authority over any insurance activity not regulated by the states.²⁴ In response, the states, working through the National Association of Insurance Commissioners (NAIC), drafted a model act to address unfair trade practices. The purpose of the model act was to ensure fair claims handling and more substantive communication between the insurer and the insured, based upon a consistent standard.

a. 1971 Model Act

In 1971, the NAIC amended the Unfair Trade Practices Act to include a separate section setting forth fourteen proscribed claims activities, the violation of which could be characterized as unfair claim settlement practices, provided that they were committed with such frequency as to indicate a general business practice.²⁵ This

²⁰ 322 U.S. 433, *reh'g denied*, 323 U.S. 811 (1944).

²¹ *Paul v. State of Virginia*, 75 U.S. 168, (1868), *overruled in part*, *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, *reh'g denied*, 323 U.S. 811 (1944).

²² 15 USC § 1011-1015.

²³ 15 USC § 1012(b), 1013(a).

²⁴ It has been suggested that the McCarran-Ferguson Act was enacted under pressure from insurance companies in order to avoid more stringent federal regulation. See ASHLEY, *supra* at note 1, § 9:02.

²⁵ UNFAIR TRADE PRACTICES ACT § 3 (1971).

reflects the Act's purpose of addressing broader unfair practices rather than individual infractions.

The majority of jurisdictions have adopted the 1971 Model Act with some variation reflecting each state's different historic approach and philosophical objectives.²⁶ Consequently, while reference to the model act is useful, in order to analyze its potential exposure in a particular jurisdiction, an insurer would be wise to review the statutes. Appendix A lists the citation to each state's unfair claims practices act.

Under the 1971 Model Act,²⁷ violation of the unfair claims settlement practices included:

- (1) Misrepresentation of relevant facts or insurance policy provisions regarding coverage;
- (2) Failure to acknowledge promptly and to act reasonably upon claims communications;
- (3) Failure to adopt and to implement reasonable standards for the prompt investigation of claims;
- (4) Refusal to pay claims without conducting a reasonable investigation based upon all available information;
- (5) Failing to affirm or to deny coverage within a reasonable time after proof of loss statements have been submitted;
- (6) Failure to affirm or to deny coverage within a reasonable period of time after completion of the investigation;
- (7) Compelling insureds to initiate litigation to recover under its insurance policy by offering substantially less than the amount(s) ultimately recovered by the insureds;
- (8) Failure to settle claims promptly where liability under one provision of the policy has become reasonably clear in order to influence settlements under other coverage provisions; and
- (9) Failure to provide a prompt and reasonable explanation of the contractual and legal basis for coverage, denial or offer of a compromise settlement.

While an insurer is well advised to adjust its operations so as to avoid committing any of those acts prohibited by the statute, there is a question as

²⁶ According to the NAIC Model Regulation Service, all states but Alabama, Iowa and Mississippi have adopted the 1971 Model Act. It does not appear that the District of Columbia, Guam or the Virgin Islands have adopted the 1971 Model Act. See *infra* Appendix A, "Statutory and Common Law Approach to Bad Faith," for the appropriate citation to state law.

²⁷ UNFAIR TRADE PRACTICES Act § 9.

to whether the 1971 Model Act poses a significant risk to bond carriers. Fidelity insurers are expressly excluded from the 1971 Model Act by some states.²⁸ In addition, although there is some disagreement among the states that have adopted the 1971 Model Act, a majority of such states have recognized that the act is not intended to create a private right of action against insurers.²⁹ While an Insurance Commissioner also could press a claim, there is a question as to the states' commitment to enforcing these provisions.³⁰ Furthermore, in order to be found liable under the 1971 Model Act, an insurer must commit a number of violations to have a "business practice" of unreasonable behavior. Generally, a single infraction will not suffice.³¹

b. 1990 Model Act

In 1990, the NAIC promulgated the Unfair Settlement Practices Act (1990 Model Act), separate from the NAIC Unfair Trade Practices Act, in order to address claims issues separately. In order to maintain a cause of action under the 1990 Model Act, the insured must prove a causal connection between the subject violation and actual harm. Whereas a single violation of the 1971 Model Act would not subject the insured to liability, the 1990 Model Act broadens the scope of liability to include a flagrant and conscious violation as well as unreasonable general business practice.³² Consequently, an insurer could be sanctioned for a single incident.

In addition, the 1990 Model Act expands the list of unfair claims practices by adding the following to the list included in the 1971 Model Act:

- (1) Failure to provide the insured with the forms necessary to submit claims within 15 calendar days of a request along with reasonable explanations regarding their use;³³ and
- (2) Failure to effectuate prompt, fair and equitable claim settlement once liability has become reasonably clear.³⁴

²⁸ See *infra* Appendix A, "Statutory and Common Law Approach to Bad Faith."

²⁹ *Id.*

³⁰ Sanford M. Gage & Jonathan T. Zackey, *The Insurance Wars: The Battle Over McCarran-Ferguson*, 18 THE BRIEF 11 (1989).

³¹ As to a fidelity insurer specifically, see *United States Fid. & Guar. Co. v. Resolution Trust Corp.*, No. 5:91:CV680 (TFGD), 1994 WL369868 (D. Conn. Mar. 14, 1994)(recommended ruling of magistrate judge)(claimant could not establish that the insurer's conduct in refusing to pay fidelity claim constituted a general business practice under either the Connecticut Unfair Insurance Practices Act or the Connecticut Unfair Trade Practices Act).

³² UNFAIR CLAIMS SETTLEMENT ACT § 3.A.

³³ *Id.* at § 4.M.

³⁴ *Id.* at § 4.D.

The 1990 Model Act incorporated several changes that are favorable to fidelity insurers. The 1990 Model Act expressly states that it does not create a private right of action and that it is not intended to apply to certain lines of insurance, including fidelity.³⁵ Nevertheless, since the 1990 Model Act has been adopted by only three states,³⁶ fidelity insurers can view its creation as only a minor victory thus far.

2. Other Statutes

States have passed other laws which may provide additional remedies to insureds. In certain jurisdictions an insured may pursue a cause of action for bad faith under consumer protection statutes, independent bad faith provisions and even the Employee Retirement Income Security Act of 1974 (ERISA) to the extent that it preempts state laws in matters involving employee benefits. Although these laws are independent of each other, a violation of a state's unfair claims settlement act will often serve as the basis for a cause of action allowable under other statutes.

More general consumer protection statutes will often not be of particular concern to fidelity insurers, however. Generally, these statutes are intended to protect individual consumers rather than the financial institutions and commercial entities that purchase fidelity insurance.³⁷

III. RECENT FIRST-PARTY FIDELITY CASE LAW

Because the law of bad faith has evolved and is continuing to evolve as a patchwork of common law and statutory precepts with significant variation from one jurisdiction to another, insurers and their advocates must maintain a wary watch on the bad faith horizon to make certain that they remain in compliance with prevailing standards for claims handling and to remain prepared to handle the almost inevitable accusations of bad faith, whether justified or not.

Although fidelity insurers generally insure financial institutions, stockbrokers, other insurance companies and commercial entities that would not normally need the protection for which the tort of bad faith was originally crafted, fidelity insurers are by no means immune from accusations of bad faith. In the 1980s, as the tort of first-party bad faith gained widespread

³⁵ *Id.* at § 1. Pursuant to the NAIC's drafting notes, this represents a clarification of its original intent rather than a change in position.

³⁶ According to the Model Regulation Service, as of April 1998, only Georgia, Missouri and Nebraska have adopted the 1990 Model Act.

³⁷ See *infra* Appendix A, "Statutory and Common Law Approach to Bad Faith" for a list of statutes of note to first-party insurers.

acceptance, a number of fidelity insurers were subjected to bad faith damage awards.³⁸

Perhaps the most serious example is *Downey Savings & Loan Association v. Ohio Casualty Insurance Co.*³⁹ Downey involved an insurer's denial of a \$100,000 fraudulent loan loss. The trial court found that the insurer had wrongfully denied coverage, after not properly investigating the loss. Moreover, the insurer had a written policy advocating that investigation of claims should focus upon potential defenses and suggesting the use of depositions to intimidate insureds. The trial court awarded \$5,000,000 in punitive damages to the insured, and the award was affirmed on appeal.

Downey and a number of other less extreme examples of bad faith damage awards⁴⁰ in the 1980s might have presaged a costly decade for fidelity insurers. However, although the tort of bad faith has certainly increased the cost of litigation for fidelity insurers, Downey appears to have been an anomaly. The following section of this article will review first-party cases of greatest significance from the past several years and integrate fidelity cases beginning in 1990⁴¹ into the discussion, to provide a snapshot of the current landscape in the wake of *Downey* and to form a basis for analysis of the current state of affairs with respect to fidelity insurers.

A. Cases Regarding Availability of an Action for Bad Faith

Although the tort of breach of the implied covenant of good faith and fair dealing has been in existence as to first-party insurance now for a quarter of a century, courts are continuing to examine the fundamental elements of the tort. The following group of cases underscore the continuing evolution of the law in this area, which compels the insurer to be wary of the possibility of continued change in the law of bad faith.

1. Adoption of the Tort

The Supreme Court of Hawaii did not expressly consider whether a first-party insured could bring an action for bad faith in tort against its insurer until 1996, in *Best Place Inc. v. Penn America Insurance Co.*⁴² The action in *Best Place* was brought by an insured nightclub destroyed by an arson fire. The insurer refused to provide payment on the claim because the insured had not submitted to examination under oath, provided proof of loss, or provided

³⁸ Haley & Wolkin, *supra* note 1.

³⁹ 234 Ca. Rptr. 835, *cert. denied*, 486 U.S. 1036 (1988).

⁴⁰ See Haley & Wolkin, *supra* note 1.

⁴¹ *Id.* Because the cases involving bad faith and fidelity insurance during the 1980s have been the subject of previous review, this article will focus on such fidelity insurance cases decided after 1990.

⁴² 920 P.2d 34 (Hawaii 1996).

requested documentation. Although apparently justified in requiring the insured to provide such information and documentation, the insurer opened the door to a claim of bad faith by subsequently failing to respond in any way to several inquiries of the insured's counsel.⁴³

The Hawaiian Supreme Court reviewed Hawaiian common law and Hawaiian statutes and ruled that Hawaii would recognize the tort of bad faith. The court expressly adopted the more liberal standard based upon *Gruenberg*, which allows the cause of action for compensatory damages when the insurer unreasonably withholds or delays payment.⁴⁴ However, as one commentator has noted, the Hawaiian court appears to have extended the cause of action in Hawaii beyond *Gruenberg*. First, the court did not clarify whether it would require that the unreasonable failure to provide payment be "without proper cause" as required under *Gruenberg*. Second, the court ruled that an action for bad faith could be maintained even where the underlying claim for coverage is meritless.⁴⁵ Thus one would anticipate that a coverage action brought against a first-party insurer under Hawaiian law will almost always include a count alleging bad faith.

The tort of first-party bad faith was also adopted in Vermont only recently, in 1995. In *Bushey v. Allstate Insurance Co.*,⁴⁶ the insured sought payment under the underinsured motorist provisions of his automobile policy after sustaining injury in an automobile accident. The insurer had provided payment for the insured's injuries one month after the accident, but one year later the insured sought coverage for substantial additional medical expenses he had incurred for a much more serious injury than had initially been diagnosed. The insurer denied coverage for the later diagnosis, based upon the opinion of its medical expert. The insurer's expert contended that the more serious injury discovered one year after the accident had in fact been sustained subsequent to the accident.⁴⁷

Unlike the Hawaiian Supreme Court, the Vermont Supreme Court did not perceive the need to make up for lost time. The Vermont court adopted a standard for first-party insurer bad faith along the lines of the majority *Anderson* view, which requires that the insured prove that the insurer "knew or recklessly disregarded" that there was no reasonable basis for denial of the claim. The court concluded that the insured's claim was "fairly debatable" and that the insurer was therefore not susceptible to a claim of bad faith. Specifically, the insured avoided bad faith liability because the first examinations of the insured had not detected the full extent of the insured's

⁴³ *Id.* at 337.

⁴⁴ *Id.* at 337-46.

⁴⁵ See 12 BAD FAITH L. REP. 117-119 (1996).

⁴⁶ 670 A.2d 807 (Vt. 1995).

⁴⁷ *Id.*

injuries and the insurer had reasonably relied upon the opinions of legal and medical experts.⁴⁸

2. The Advent of the "Reasonably Clear" Standard in Texas

In Texas, first-party insureds have had the right to pursue the tort of bad faith for over a decade,⁴⁹ but the courts are still grappling with the proper parameters for the tort. Prior to 1997, the Texas Supreme Court had seemed content to apply a standard for first-party bad faith similar to the prevailing view first articulated in *Anderson*: that an insurer breaches its duty of good faith and fair dealing when the insurer is shown to have no reasonable basis for denying or delaying payment of a claim, and the insurer knew or should have known of that fact.⁵⁰ However, the Texas Supreme Court has now modified its approach in a way that may expand the tort in that state, notwithstanding the court's articulated purpose of attempting to adjust the balance slightly to aid insurers.

In 1997 the Texas Supreme Court issued two opinions on the same day dealing with the issue of first-party bad faith. In *Universe Life Insurance Co. v. Giles*⁵¹ a health insurer denied coverage based upon information it had received from the insured's doctor indicating that the condition for which she sought coverage had existed prior to the issuance of the health insurance policy. Subsequently, the insured's doctor provided supplemental information indicating that the insured's condition had not been detected prior to the issuance of the policy. The insurer persisted in its denial until it received a letter from the insured's counsel. It then paid most of the insured's medical expenses but denied coverage for a portion it considered unreasonable and refused to provide payment of the insured's attorneys' fees.⁵² At trial the insured obtained an award of damages for mental anguish and punitive damages, based upon bad faith. The court of appeals affirmed the trial court ruling in all respects, except that it found that the punitive damages should be reduced pursuant to statutory limitation under Texas law. The Texas Supreme Court affirmed the award of damages for mental anguish resulting from bad faith but reversed the award of punitive damages.⁵³

In *State Farm Lloyds v. Nicolau*,⁵⁴ a homeowner's insurer had denied coverage for damage to the insureds' home foundation. The policy at issue provided coverage for damage caused by water leak but did not provide cov-

⁴⁸ *Id.* at 811.

⁴⁹ See *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987).

⁵⁰ See *Aranda v. Insurance Co. of North Am.*, 748 S.W.2d 210, 213 (Tex. 1988).

⁵¹ 950 S.W.2d 48 (Tex. 1997).

⁵² *Id.* at 48-50.

⁵³ *Id.* at 57.

⁵⁴ 951 S.W.2d 444 (Tex. 1997).

erage for settling of the home. Coverage depended upon whether the damage to the home was caused by a leak in the sewer line close to the home, or simply by settling. After a series of examinations by several engineers who issued conflicting opinions, the insurer denied coverage. The insured filed suit and prevailed at trial as to the issue of coverage. The jury further awarded damages for mental anguish, punitive damages and attorneys' fees. The trial court disregarded the jury's award of extra-contractual damages, but the damages were reinstated on appeal.⁵⁵ The Texas Supreme Court affirmed the award of damages for mental anguish but reversed the order of exemplary damages resulting from malice. However, the court left open the possibility that the insured might be entitled to additional extra-contractual damages under the Texas business statutes prohibiting unfair or deceptive acts or practices. The court remanded the case to the court of appeals for consideration of damages resulting from unfair business practices based upon the record produced at trial.⁵⁶

In both the *Giles* and *Nicolau* decisions, the court applied a new standard for first-party insurer bad faith in its analysis. Instead of requiring that the insured show that there was no reasonable basis for denial of the claim and that the insurer knew or should have known it, the Texas Supreme Court modified the analysis to require an insured to demonstrate that the insurer denied payment after coverage has become reasonably clear.

The Texas Supreme Court adopted this "reasonably clear" standard in an attempt to enable appellate courts in the state to apply a "no-evidence" standard of review to bad-faith findings. Specifically, the court noted that a plaintiff seeking to prove bad faith must prove the absence of a reasonable basis for denial. Nevertheless, under the "no-evidence" standard of review the appellate court would need to resolve all conflicts in the evidence and draw all inferences in favor of the bad faith finding. This would then preclude the appellate court from consideration of the insurer's evidence that its denial was reasonable and would therefore preclude any reversal of a finding of bad faith.⁵⁷ By adopting the "reasonably clear" standard, the Texas Supreme Court sought to eliminate this quandary because the insured would be required to prove a positive rather than a negative proposition. In the court's view the new standard would have little effect on the substantive requirement for bad faith.⁵⁸

⁵⁵ *Id.* at 444-48.

⁵⁶ *Id.* at 453.

⁵⁷ *Giles*, 950 S.W.2d at 51-52.

⁵⁸ *Id.* at 57 (majority opinion), 59 (concurring opinion).

Several commentators have roundly criticized the "reasonably clear" standard.⁵⁹ First, although it is intended to allow for better appellate review under the "no-evidence" standard, the court has not articulated how, as a practical matter, this alteration of the standard will eliminate the problem. Whether the plaintiff must prove a negative proposition or not, the concern is that after a bad faith verdict is rendered at the trial court level, Texas appellate courts are precluded from any consideration of the insurer's evidence that that denial was reasonable. This is especially true because the Texas Supreme Court has affirmatively stated that the question of bad faith should generally be resolved as a question of fact, and not as a matter of law.

Second, and perhaps more significantly, the "reasonably clear" standard may actually increase the insurer's susceptibility to bad faith claims, even though the Texas Supreme Court expressly stated that the new standard was not intended to alter the substantive requirement for bad faith. As one commentator has noted, unless precisely instructed, a jury could conclude that coverage was "reasonably clear" even in cases in which legitimate coverage issues were unresolved.⁶⁰

There have been no bad faith fidelity cases issued under Texas law after the adoption of the "reasonably clear" standard. It should be noted, however, that prior to 1997 fidelity insurers had fared well in avoiding claims of bad faith under Texas law.⁶¹

3. More Conservative Views: Illinois, Kansas and Minnesota

Not all recent developments regarding first-party bad faith have resulted in increased vulnerability of insurers to bad faith claims. Illinois, Kansas and Minnesota have remained unwilling to allow for the expansion of bad faith claims.

a. Illinois Statutory Preemption

The Illinois Supreme Court recently ruled that a tort action for bad faith may not be pursued against first-party insurers in Illinois. In *Cramer v. Insurance*

⁵⁹ See Michael Sean Quinn, *Insurer Bad Faith--Sic et Non--Texas Style*, 19 INS. LITIG. REP. 485 (1997); Stephen S. Ashley, *The Texas Supreme Court Makes A Mess*, 13 BAD FAITH L. REP. 137 (1997); William T. Barker, *The Texas Bad Faith Trilogy: Bombshell or Dud?*, 13 BAD FAITH L. REP. 165 (1997).

⁶⁰ Barker, *supra* n.59, at 167. But note that at least one court applying the new standard expressly rejected any attempt to use *Giles* to expand the scope of the tort in this manner. *Tucker v. State Farm Fire and Cas. Co.*, 981 F. Supp. 461, 466 n.4 (S.D. Tex. 1997).

⁶¹ See *Federal Deposit Ins. Corp. v. United States Fire Ins. Co.*, 956 F. Supp. 701 (N.D. Tex. 1996)(no bad faith where fidelity insurer had properly denied coverage based on timing of discovery); *Lynch Properties Inc. v. Potomac Ins. Co. of Illinois*, 962 F. Supp. 956 (N.D. Tex. 1996), *aff'd.*, 140 F.3d 622 (5th Cir. 1998) (no bad faith where fidelity insurer had properly and promptly denied coverage based upon lack of direct loss to insured and lack of manifest intent to cause loss to insured).

*Exchange Agency*⁶² an insured under a homeowner's policy sought coverage in connection with a burglary. The insurer denied coverage because the burglary had occurred after the policy had been canceled. The insured filed suit *pro se*, alleging he had never been provided a cancellation notice and that the insurer's purported cancellation was fraudulent.

In the trial court the insurer sought summary judgment based upon a contractual one-year limitation period provided in the policy. To the extent that the insured had sought damages in tort for fraudulent cancellation, the insurer argued that the action was preempted by a provision of the Illinois Insurance Code that allows insureds to recover statutorily limited amounts in the event of "vexatious and unreasonably delay" of claims settlement.⁶³ The trial court denied the insurer's motion but certified the issue for interlocutory appeal. The court of appeals likewise rejected the preemption argument and ruled that the insured's action for fraud could proceed.⁶⁴

The Illinois Supreme Court reversed and remanded with directions to the trial court to enter summary judgment in favor of the insurer. The court ruled that in Illinois the concerns with regard to first-party bad faith have been addressed adequately by statute. Although an Illinois insured under a third-party liability policy may assert the tort of bad faith, Illinois provides an adequate remedy for first-party insurer misconduct under section 155 of the Illinois Insurance Code.⁶⁵ The court then examined the insured's complaint and concluded that his claim of fraudulent cancellation was tantamount to a claim of bad faith and, therefore, was preempted. The insured was left with a cause of action in contract, which was untimely under the contractual limitation period.

It is interesting to note that in two fidelity bond cases decided prior to *Cramer*, federal courts applying Illinois law had already ruled that section 155 of the Illinois Insurance Code would preempt a cause of action for bad faith against a first-party insurer.

⁶² 675 N.E.2d 897 (1997).

⁶³ 215 ILCS 5/155 (West 1994).

⁶⁴ 675 N.E.2d at 898.

⁶⁵ 215 ILCS 5/155 (West 1994). This statute provides a statutory penalty for vexatious and unreasonable delay in settlement.

In *Beverly Bancorporation v. Continental Insurance Co.*⁶⁶ the insured under a financial institution bond sought recovery in a two-count complaint for breach of contract. The insured sought consequential damages and attorneys' fees for breach of contract, damages resulting from alleged bad faith refusal to pay, and compensatory damages, attorneys' fees and statutory penalties under section 155 of the Illinois Insurance Code.⁶⁷ The district court of Illinois, following a prior ruling by the Seventh Circuit,⁶⁸ ruled that the insured's claims for bad faith would be preempted by section 155 of the Illinois Insurance Code because the claims were based upon the insurer's alleged unreasonable and vexatious delay of payment, which is the subject matter addressed by the statute.⁶⁹

The court also ruled that the insured could not recover attorneys' fees and consequential damages for breach of contract from the insurer because such damages are excluded under the bond. The court viewed the exclusion of such damages to be within the freedom of the parties to limit damages contractually under Illinois law.⁷⁰

Similarly, the district court of Illinois, in *Heller International Corp. v. Sharp*,⁷¹ again noted that section 155 of the Illinois Insurance Code would preempt claims for extra-contractual damages for bad faith. However, the insured in *Heller* was still able to state a cause of action for damages in excess of policy limits notwithstanding the statutory preemption.

Heller involved protracted litigation concerning the fidelity coverage provided under a comprehensive commercial bond. An opinion issued in 1990 described the insured's second amended complaint as seeking recovery for compensatory and punitive damages.⁷² By the time of the court's final published decision in 1994, the insured's sixth amended complaint had been refined to seek \$10 million in compensatory damages, based upon the limit of liability under the bond at issue, and an additional \$10 million in lost interest, arising solely as consequential damages from breach of contract.⁷³ Because the insured styled the case as an action for consequential damages arising from the insurer's breach of contract and did not premise its recovery upon allegations of bad faith, the court ruled that the insured's sixth

⁶⁶ No. 92-C-4823, 1992 WL 345420 (E.D. Ill. No. 17, 1992) (memorandum opinion).

⁶⁷ *Id.* at *1.

⁶⁸ *Kush v. American States Ins. Co.*, 853 F.2d 1380 (7th Cir. 1988).

⁶⁹ *Beverly*, 1992 WL 345420 at *3-*5.

⁷⁰ *Id.* at *2.

⁷¹ 857 F. Supp. 627 (N.D. Ill. 1994).

⁷² No. 85C-3381, 1990 WL 119628, at *1 (N.D. Ill. Aug. 15, 1990)(memorandum opinion).

⁷³ 857 F. Supp. 627 (N.D. Ill. 1994).

amended complaint stated a valid cause of action for the \$10 million in excess of the policy. The insurer was advised that it would need to look to the Illinois law of contracts to avoid damages in excess of the bond limits.⁷⁴

b. Kansas Resists Change

Likewise, Kansas remains unreceptive to the expansion of first-party insurer liability for bad faith. The district court of Kansas has recently examined this question twice in the context of fidelity insurance claims.

In *Lyons Federal Savings and Loan v. St. Paul Fire and Marine Insurance Co.*⁷⁵ the insured sought coverage for loan losses under the servicing contractor insuring agreement of a financial institution bond. The insurer denied coverage based upon the loan loss exclusion, and the insured filed suit for breach of contract and to recover attorneys' fees under the Kansas Fair Claims Practices Act.

The court agreed with St. Paul that the losses were excluded. In considering the issue of bad faith, the court noted first that under Kansas law there is no tort of bad faith claims administration and that there is no private right of action under the Kansas Fair Claims Practices Act. The court further ruled that, in any event, because St. Paul had properly denied coverage, there could be no viable claim for bad faith.⁷⁶

Notwithstanding the ruling in *Lyons*, the RTC shortly thereafter requested the same court to consider the first-party insurer bad faith in *Resolution Trust Corporation v. Fidelity & Deposit Co. of Maryland*.⁷⁷ The RTC argued that under Kansas law damages for the tort of bad faith should be allowed where the legislative remedies available are only nominal in comparison to the amount of coverage at issue.

The district court reviewed in detail the Kansas Supreme Court decision in *Spencer v. Aetna Life & Casualty Insurance Co.*⁷⁸ and concluded unequivocally Kansas does not permit a first-party insured to bring a cause of action in tort for bad faith.

⁷⁴ *Id.* at 629-32. Note that it is not clear from the opinion whether the coverage would have excluded such damages, as was the case in *Beverly*.

⁷⁵ 863 F. Supp. 1441 (D. Kan. 1994).

⁷⁶ *Id.* at 1449.

⁷⁷ 885 F. Supp. 228 (D. Kan. 1995).

⁷⁸ 611 P.2d 149 (Kan. 1980).

c. Minnesota Resists Change

Likewise, a Minnesota Court of Appeals has recently reaffirmed that state's position that there is no cause of action in tort for first-party insurer bad faith. In *Cherne Contracting Corp. v. Wausau Insurance Cos.*⁷⁹ a workers' compensation insured sought to bring a tort action for bad faith in connection with its insurer's calculation of retroactive premiums. Although Minnesota recognizes that "an insurer owes its insured a duty of good faith," breach of that duty will not give rise to an action in tort unless there is a tort independent of the contract.⁸⁰ The court affirmed the trial court's denial of the insured's request to amend its complaint to seek tort damages for bad faith.⁸¹

4. Federal Common Law Rejected as Basis for Punitive Damages

In *Federal Deposit Insurance Corp. v. Aetna Casualty & Surety Co.*⁸² the FDIC sought to avoid the restrictions under Tennessee law that limit an insured's right to recover punitive damages by invoking federal common law.

At the trial court level the FDIC was successful. The insurer had denied coverage based upon an exclusion that terminated coverage upon takeover by regulators. The district court awarded punitive damages to the FDIC under federal common law for the insurer's alleged wrongful denial of the claim, misconduct during the investigation of the loss and improper tactics during the discovery phase of the litigation.⁸³ After ruling that the FDIC was not entitled to coverage, the Sixth Circuit also ruled that the district court had abused its discretion in awarding punitive damages. Most significantly, the Sixth Circuit dismissed the notion that the FDIC could recover punitive damages based upon federal common law.⁸⁴ The court looked instead to Tennessee common law to decide the issue. Under Tennessee common law punitive damages are recoverable only upon a showing of "fraud, malice, oppression or gross negligence;" and such damages are not generally allowed in breach of contract cases.⁸⁵

⁷⁹ 572 N.W.2d 339 (Minn. Ct. App. 1997), *rev. denied*, (Feb. 19, 1998).

⁸⁰ *Id.* at 343-44.

⁸¹ *Id.*

⁸² 903 F.2d 1073 (6th Cir. 1990).

⁸³ *Id.* at 1079-80.

⁸⁴ *Id.*

⁸⁵ *Id.* at 1079-80. *Persian Galleries, Inc. v. Transcontinental Ins. Co.*, 38 F.3d 253 (6th Cir. 1994), further clarifies that Tennessee courts do not recognize a tort of bad faith. An insured is confined to a limited recovery for bad faith refusal to pay, in the event the insured can establish that it was damaged, under Tenn. Code Ann. § 56-7-105 or, in limited circumstances relating to the marketing of insurance, under the Tennessee Consumer Protection Act.

B. Cases Regarding the Impact of Insured Misconduct Upon Bad Faith

It is logical that cases involving allegations of bad faith would often involve allegations of insured misconduct. Where an insurer raises the insured's misconduct as a defense to coverage, it is predictable that the insured, whether at fault or not, will seek to return the favor. This is especially true where the insurer has accused the insured of criminal or fraudulent behavior or both, since such claims, if incorrect, are more likely to support claims for extracontractual damages for emotional distress or mental anguish.⁸⁶

An insured's misconduct is also relevant to the issue of bad faith simply because it will often determine the question of coverage, and the question of whether coverage has been properly denied will often determine issues of bad faith.⁸⁷ Most insurance contracts, including fidelity insurance, include express requirements that may provide the insurer with a defense in the event of insured misconduct. Such language may include a cooperation clause, reporting, notice and proof of loss requirements, or even exclusions related to misrepresentation, failure to mitigate damages, or other behavior prejudicial to the insurer's rights.

In addition, courts have recently begun to consider whether the insured's bad faith might provide a tort defense to the insured's claim of bad faith, whether comparative negligence principles ought to apply in cases of insurer and insured bad faith, and whether a cause of action against an insured might exist for "reverse bad faith."

1. Insured Misconduct Short of Fraud

If it can be established, an insured's misconduct need not rise to the level of fraud to provide a defense to allegations of bad faith. When an insured hinders or obstructs the insurer's investigation, the insured may forfeit its ability to be critical of the insurer's investigation and coverage decision, even if the insurer proves to have been incorrect. In *Turner v. Liberty National Fire Insurance Co.*⁸⁸ the insurer denied coverage for a fire that, according to an expert, had started under suspicious circumstances.⁸⁹ When the insurer and its adjuster sought to question the insured regarding the fire, he refused to cooperate. Although the jury in the case awarded the insured damages for

⁸⁶ See, e.g., *Tucker v. State Farm Fire and Cas. Co.*, 981 F. Supp. 461 (S.D. Tex. 1997)(insured accused of arson); *Gregg v. Allstate Ins. Co.*, 126 F.3d 1080 (8th Cir. 1997)(insured accused of misrepresentation of loss history and arson); *United States Fid. & Guar. Co. v. King Enterprises, Inc.*, 982 F. Supp. 415 (N.D. Miss. 1997)(insured accused of arson); *Bush v. Ford Life Ins. Co.*, 682 So. 2d 46 (Ala. 1996)(insured accused of misrepresentation in insurance application); *Persian Galleries, Inc. v. Transcontinental Ins. Co.*, 38 F.3d 253 (6th Cir. 1994)(insured accused of staging theft of inventory).

⁸⁷ See *supra* note 61.

⁸⁸ 681 So. 2d 589 (Ala. Ct. App. 1996).

⁸⁹ *Id.* at 591.

breach of contract, the insurer obtained a directed verdict on the issue of bad faith because of the insured's intractability. The directed verdict was affirmed on appeal.⁹⁰

In *Rheil v. Wisconsin County Mutual Insurance Corp.*⁹¹ the insured sought recovery of damages for bad faith because an insurer evaluating his claims for uninsured motorist coverage had not provided him with an evaluation of his claim or a settlement offer prior to trial. The court noted that, while it is quite unusual, the insurer was justified in not providing the insured an evaluation of the claim or a settlement offer because the insured's repeated insistence upon receiving the policy limits had made it clear that the insured would accept no valuation of the case below his demand. Although a first-party insurer is generally expected to provide its insured with an evaluation of the claim and, if warranted, an offer for settlement, the inflexibility of the insured in *Rheil* had rendered any evaluation or discussion a futile exercise for the insurer.⁹²

Similarly, in *First United Financial Corp. v. United States Fidelity & Guaranty Co.*⁹³ the insurer had received a proof of loss seeking coverage in connection with third-party claims against the insured. When the claims were abandoned, the insurer ceased its investigation of the loss. The district court granted summary judgment in favor of the insurer because of the insured's failure to provide proper evidence of dishonesty. The district court further ruled that the question of bad faith was rendered moot because of its ruling on coverage.⁹⁴

The Fifth Circuit affirmed, noting that the insurer had reasonably ceased its review of the matter upon learning that the third-party suit had been abandoned. The court noted that the proof of loss had not sought recovery for alleged employee dishonesty but was instead confined to the insured's liability in connection with the third-party suit. The concurring opinion rendered by one of the three judges on the panel details further that the insured had apparently attempted to create a bad faith claim retroactively by mischaracterizing what it had sought in its proof of loss. Some three years after the proof of loss had been submitted and after the insured had informed the insurer that the third-party claim had been abandoned, the insured forwarded a demand letter to the insurer alleging that its proof of loss had sought cover-

⁹⁰ *Id.* at 591-92. See also *Brown v. Danish Mutual Ins. Assoc.*, 550 N.W.2d 171 (Iowa Ct. App. 1996)(court upheld summary judgment in favor of insurer as to coverage and bad faith because insured had refused to provide sworn statement under oath regarding alleged theft of antiques).

⁹¹ 568 N.W.2d 4 (Wis. Ct. App. 1997).

⁹² 568 N.W.2d 4 at 7-8.

⁹³ 96 F.3d 135 (5th Cir. 1996)(applying Mississippi law).

⁹⁴ *Id.* at 137-38.

age under the first-party provisions in the bond and that the insurer had acted in bad faith by failing to investigate the matter.⁹⁵

2. Insured Bad Faith

Insured misconduct is not often stated as a breach of the implied covenant of good faith and fair dealing, perhaps because the insured's misconduct gives rise to other contractual and equitable defenses that are more readily established. Nevertheless, California courts have recognized that the covenant may be breached by an insured and may give rise to a cause of action by an insurer.⁹⁶

The Ninth Circuit considered this issue in the context of a fidelity bond in *Mercedes-Benz of North America, Inc. v. Hartford Accident & Indemnity Co.*⁹⁷ *Mercedes-Benz* involved a claim for employee theft of automobile parts. The insurer denied coverage based upon the timing of discovery, which would have triggered termination of coverage as to an employee and which would have rendered the claim untimely under the limitations period in the bond. A plant manager for the insured had confronted an employee concerning the theft of parts in December 1979, but the employee was not discharged, and the thefts continued until 1982. The insurer later filed a declaratory judgment action in New Jersey, and the insured filed an action two weeks later in California alleging breach of contract, bad faith and violation of the California Insurance Code. Hartford counterclaimed, alleging breach of contract, bad faith, fraudulent concealment and intentional misrepresentation.

After the insurer obtained summary judgment on the issue of the timing of the insured's discovery, a jury returned a verdict for the insured for \$100,000, for its pre-discovery losses; but it then awarded the insurer \$5,000 in compensatory damages and \$4.5 million in punitive damages in connection with the insured's claims for post-discovery losses. Although the insurer agreed to accept a remittitur reducing the punitive damages to \$500,000, both parties appealed.

The appellate court found that the trial court had erred in granting the insurer's motion for summary judgment on the issue of the timing of discovery. The court affirmed the award of pre-discovery compensatory damages for the insured but remanded the question of discovery and hence the issue of punitive damages, for both the insured and insurer, to the trial court.

The appellate court further clarified that the insurer could not recover damages for breach of the cooperation clause in the bond, that contract dam-

⁹⁵ *Id.* at 137.

⁹⁶ See *California Fair Plan Assoc. v. Politi*, 270 Cal. Rptr. 243 (1990).

⁹⁷ 974 F.2d 1342 (table) (9th Cir. 1992).

ages for bad faith are not available under California law, and that attorneys' fees were not recoverable. Nevertheless, the insurer could recover punitive damages for fraudulent concealment, depending upon the jury's decision as to the timing of discovery of the loss by the insured.⁹⁸

Another fidelity insurer sought to establish insured bad faith before the Ninth Circuit in *Interstate Production Credit Association v. Fireman's Fund Insurance Co.*⁹⁹ The *Interstate* opinion was the third in a series involving a loss resulting from loans to an entity controlled by a director of the insured. Initially in the district court the insurer obtained summary judgment as to coverage, based upon a lack of causal connection between the alleged fraud of the director and the ultimate loan losses.¹⁰⁰ The insured obtained a reversal of the summary judgment on appeal to the Ninth Circuit,¹⁰¹ and on remand the district court considered additional arguments of the insurer as to coverage, including an affirmative defense based upon the insured's alleged breach of the implied covenant of good faith and fair dealing.

The insurer argued that the loans giving rise to the loss had been made in violation of the insured's own regulations, policies and credit requirements. The insured argued in response that the insurer's argument was actually an attempt to assert contributory negligence, which is not available as a defense to a first-party insurance claim.

The court did not directly address the insured's contention that the insurer's argument was simply an attempt to assert contributory negligence, or whether contributory negligence is categorically precluded as an affirmative defense to a fidelity bond claim. The court first noted that the purpose of the implied covenant of good faith and fair dealing is "to prohibit improper behavior in the performance of contracts and to effectuate the reasonable contractual expectations of the parties." The court granted summary judgment as to the insurer's defense because it found "there are not facts in this record to support the claim of [the insurer] that [the insured] did not act in good faith and deal fairly in the administration of this loan."¹⁰² Although the insurer did not successfully establish the insured's bad faith, the decision appears to assume that the insurer could have done so, notwithstanding the insured's argument that contributory negligence may not be asserted as a defense to a bond claim.

⁹⁸ *Id.* at *3.

⁹⁹ 788 F. Supp. 1530 (D. Or. 1992).

¹⁰⁰ 736 F. Supp. 225 (D. Or. 1990).

¹⁰¹ 944 F.2d 536, 539 (9th Cir. 1991).

¹⁰² *Id.* at 1537.

An insurer recently successfully established an insured's breach of the covenant of good faith in *Andrade v. Jennings*.¹⁰³ In *Andrade* an insured had obtained primary coverage from an insurer that had become insolvent prior to settlement of the claims of the insured's employee. The employee of the insured brought an action against the insured in federal court, and in connection with those proceedings the insured entered into a collusive settlement with its injured employee in order to protect its own interests and apparently to provide a settlement amount to the employee that would exceed the primary policy limits.¹⁰⁴ In a separate state court proceeding initiated by the insured, the employee obtained summary judgment against the excess insurer for the amount that exceeded the primary policy limits. However, the court of appeals reversed and remanded the action based upon the evidence in the record that the settlement between the insured and its employee was collusive.¹⁰⁵

On remand, a jury ruled in favor of the excess insurer, finding that the insured's settlement was fraudulent, the insured had breached the implied covenant of good faith and fair dealing owed to the excess insurer, and the insured had breached the assistance and cooperation requirements under the excess Policy.¹⁰⁶ The ruling was affirmed on appeal. Nevertheless, the court of appeals left open the issue of whether the injured employee could, notwithstanding the finding of collusion to which he was a party, still pursue a direct action against the excess insurer.¹⁰⁷

The Ohio Supreme Court expressly rejected the tort of "reverse bad faith" in *Tokles & Son, Inc. v. Midwestern Indemnity Co.*¹⁰⁸ An insured had been in a dispute concerning the ownership of an insured tractor trailer unit, which he had reported as being stolen while it was being used by a party to the dispute. The trial court dismissed the insured's bad faith claim by summary judgment after trial but further dismissed *sua sponte* the insurer's counterclaims for fraud and reverse bad faith. On appeal, the ruling on the insured's bad faith claim was reversed; but the ruling concerning reverse bad faith was affirmed. The matters were then certified to the Ohio Supreme Court.¹⁰⁹

Although the issue of coverage would need to be remanded to the trial court for consideration of the insured's testimony with regard to damages,

¹⁰³ 62 Cal. Rptr. 2d 787 (1997).

¹⁰⁴ *Id.* at 788-95.

¹⁰⁵ *Id.* at 794-95.

¹⁰⁶ *Id.* at 795.

¹⁰⁷ *Id.* at 803.

¹⁰⁸ 605 N.E.2d (Ohio 1992).

¹⁰⁹ *Id.* at 938-40.

the Ohio Supreme Court agreed that the insurer was entitled to summary judgment as to the issue of bad faith because the insurer had a reasonable basis for denial of coverage.¹¹⁰ As to reverse bad faith, the court expressly ruled that Ohio would not recognize such an action, stating:

This court has never recognized such a tort and refuses to do so now. As the holder of the purse strings, the insurer has a certain built-in protection from such evils. On the other hand, the insured, who often finds himself in dire financial straits after the loss, must have the equal footing which is provided by the ability to sue the insurer for bad faith.¹¹¹

Although the court rejected the tort of reverse bad faith, it reversed the order of summary judgment as to the insurer's counterclaim, noting that the insurer had enough evidence to overcome summary judgment as to the issue of fraud.¹¹²

A fidelity insurer failed to obtain damages for either fraud or bad faith in *First Lehigh Bank v. North River Insurance Co.*¹¹³ The insurer sought recovery of its investigation expenses and litigation costs based upon allegations that the insured bank had destroyed and altered documents that would have shown that alleged unauthorized loans had been reviewed by disinterested bank personnel or the insured's board of directors or both.¹¹⁴

The district court dismissed the insurer's counterclaim, ruling that the insurer's investigation expenses were not the result of the alleged fraud and that, although breach of the duty of good faith and fair dealing would form the basis of an affirmative defense, it would not give rise to a cause of action for damages.¹¹⁵ However, the court noted that the insurer, if it could prove its allegations, might be able to pursue an action for malicious use of process under Pennsylvania statute.¹¹⁶

In *Schulz v. Liberty Mutual Insurance Co.*¹¹⁷ the insurer sought a recovery from the insured for bad faith under Massachusetts law in the context of a third-party bad faith claim. In *Schulz* the victims of an automobile accident had rejected several offers for settlement prior to and during trial. The insurer engaged in preliminary settlement discussions, but the discussions

¹¹⁰ *Id.* at 942-43.

¹¹¹ *Id.* at 945.

¹¹² *Id.*

¹¹³ No. 88-7746, 1989 WL 146654 (E.D. Pa. Dec. 4, 1989)(memorandum opinion).

¹¹⁴ *Id.* at *1.

¹¹⁵ *Id.* at *2-*4. This result was perhaps predictable, since Pennsylvania does not recognize a tort of bad faith for first-party insurer bad faith, either. See *D'Ambrosio V. Pennsylvania Nat'l Cas. Ins. Co.* (Pa. 1981).

¹¹⁶ *Id.* at *5.

¹¹⁷ 940 F. Supp. 27 (D. Mass. 1996).

were interrupted by the insured's bankruptcy. Before a stay in the bankruptcy proceedings had been lifted, the claimants filed actions first against the insured and later directly against the insurer. After the stay in bankruptcy was lifted, the parties resumed settlement discussions but could not reach an agreement.

A jury trial in the action against the insured commenced first. The jury rendered a verdict in favor of the claimants for an amount, including interest, totaling less than one-third of the claimants' demands and less than half of the insurer's last rejected settlement offer. Following the verdict, the insurer sought to amend its answer in the direct action to add a counterclaim of bad faith against the claimants. The insurer argued that it should be entitled to seek damages from the claimants in view of their refusal to negotiate in good faith as indicated by the disparity of the outcome when compared to claimants' demands, and the claimants' attempt to pursue a civil action despite knowledge of pending bankruptcy proceedings.¹¹⁸

The district court rejected the insurer's request. Although it acknowledged that precedent cited with approval by a Massachusetts Court of Appeals indicates that the duty of good faith and fair dealing is reciprocal¹¹⁹ and that the claimant's conduct might be relevant for consideration of the insurer's affirmative defenses, the court would not extend this principle to create a new cause of action for the insurer. However, the court hinted that the argument for such a cause of action might be more compelling in a case involving first-party insurance.¹²⁰

3. Comparative Negligence Principles

California courts have indicated that because the covenant of good faith and fair dealing is reciprocal in nature, an insurer should be entitled to invoke comparative negligence principles to reduce its liability for bad faith where the insured's conduct has increased its liability.¹²¹ Although this view is supported by several commentators,¹²² it has not gained widespread acceptance. Montana, Texas and Florida have rejected the application of comparative

¹¹⁸ *Id.* at 29-30.

¹¹⁹ See *Parker v. D'Avolio*, 664 N.E.2d 858 (Mass. App. Ct. 1996), citing *Twin City Fire Ins. v. Country Mutual Ins. Co.*, 23 F.3d 1175, 1180 (7th Cir. 1994) and *Transit Cas. Co. v. Spink Corp.*, 156 Cal.Rptr. 360 (Cal. 1979).

¹²⁰ The court distinguished the third-party case before it from two first-party cases in which courts in other jurisdictions had acknowledged the reciprocal nature of the duty of good faith and fair dealing. *Schulz*, 940 F. Supp. at 31.

¹²¹ *Patrick v. Maryland Cas. Co.*, 267 Cal. Rptr. 24 (1990); *California Cas. Gen. Ins. Co. v. Superior Court*, 218 Cal. Rptr. 817 (1985); see also *Fleming v. Safeco Ins. Co.*, 206 Cal. Rptr. 313 (1984).

¹²² Bopp, *supra* note 1; James Wm. Walker, COMPARATIVE BAD FAITH – ITS TIME HAS COME IN TEXAS, 55 Tex. B.J. 792 (1992).

fault as a defense to insurer bad faith.¹²³ Moreover, a California court has recently voiced its opinion that the state should reconsider its prior acceptance of comparative fault principles in cases of bad faith.

In *Kransco v. American Empire Surplus Lines Insurance Co.*¹²⁴ a liability insurer was found to have acted in bad faith in failing to settle a suit by a third-party claimant for an amount within its policy limits. The claimant later obtained a verdict substantially in excess of the policy limits. The insurer sought to reduce its liability for the verdict by allocating the payment between itself and its insured. In the insurer's view, the size of the verdict was the result of the jury's angry reaction to the insured's lack of candor during pretrial discovery. The insurer convinced the jury to allocate liability for the verdict at only ten percent for itself and ninety percent for the insured, in view of the insured's comparative bad faith.¹²⁵ After the trial court reconsidered the application of comparative fault in this case, it rendered a judgment notwithstanding the verdict in favor of the insured. The insurer appealed.¹²⁶

The California Court of Appeal, after taking the opportunity to critique the existing California cases regarding the application of comparative fault principles in the context of bad faith, agreed with the trial court's final ruling. The court concluded that the use of comparative fault to reduce the damages of third-party insurer bad faith in one previous California case was erroneous.¹²⁷ The opinion appears to be less critical of the reduction of damages for insurer bad faith in cases of first-party insured misconduct, however; in this context the reduction of damages for bad faith or negligence of the insurer may simply be viewed as application of contract law. While the court acknowledged that both parties to the insurance contract are bound by the covenant of good faith and fair dealing, the breach of the covenant, in the court's view, should only be considered a tort when committed by the insurer. The breach of the covenant by the insured should remain a matter of contract law.¹²⁸

¹²³ *Stephens v. Safeco Ins. Co. of Am.*, 852 P.2d 565 (Mont. 1993); *Texas Farmers Ins. Co. v. Soriano*, 844 S.W.2d 808 (Tex. Ct. App. 1992); *Nationwide Property & Cas. Ins. Co. v. King*, 568 So. 2d 990 (Fla. Dist. Ct. App. 1990).

¹²⁴ 63 Cal. Rptr. 2d 532 (Cal. 1997), *rev. granted*, 942 P.2d 414, 67 Cal. Rptr. 2d 167 (Cal. 1997).

¹²⁵ *Id.* at 533-35.

¹²⁶ *Id.* at 536.

¹²⁷ *California Cas. Gen. Ins. Co. v. Superior Court*, 218 Cal. Rptr. 817 (1985).

¹²⁸ *Id.* at 538-42.

The California Supreme Court has granted review of the *Kransco* decision and has stated that it will consider "whether an insurer may assert an affirmative defense of the insured's comparative bad faith in a bad faith action brought against the insurer."¹²⁹ We would, therefore, expect that more definitive guidance regarding this issue will be forthcoming, at least insofar as California is concerned.

4. The Advice of Counsel Defense

Attorneys play a crucial role in the claims process because a correct coverage opinion will often depend upon a correct analysis of existing case law. In some cases insurers have avoided liability for bad faith because their coverage opinion, although incorrect, had been based upon the advice of counsel.¹³⁰

However, if an insurer perceives that it may avoid bad faith by invoking its reliance upon the advice of counsel, the insurer must also be prepared to waive any privilege it might otherwise assert with regard to such matters.¹³¹ Moreover, some courts have recently rejected the view that an insurer can avoid bad faith by relying upon counsel.

For example, in *Klinger v. State Farm Mutual Auto. Insurance Co.*¹³² the Third Circuit upheld an award of punitive damages for the insurer's bad faith denial of an uninsured motorist claim. The insurer argued that it was not at fault because its counsel had failed to relay to it the results of an arbitration favorable to the insured's position. However, it appeared that the insurer had reason to know that its counsel was dilatory with respect to the matter because of a conversation between a representative of the insurer and the insured's counsel, several months after the arbitration decision had been rendered.¹³³

¹²⁹ 942 P.2d 414 (1997).

¹³⁰ See, e.g., *Lynch Properties, Inc. v. Potomac Ins. Co. of Illinois*, 962 F Supp. 956, 961-64 (N.D. Tex 1996), *aff'd.*, 140 F.3d 622 (5th Cir. 1998); *Bushey v. Allstate Ins. Co.*, 670 A.2d 807, 811 (Vt. 1995). *State Farm Mutual Auto. Ins. Co. v. Superior Court*, 279 Cal. Rptr. 116, 117 (Cal. Ct. App. 1991); *Vincinanzo v. Brunshwig & Fils, Inc.*, 739 F. Supp. 891, 894 (S.D.N.Y. 1990); *Boston Symphony Orchestra, Inc. v. Commercial Union Ins. Co.*, 545 N.E.2d 1156 (Mass. 1989); *Brandon v. Sterling Colorado Beef Co.*, 827 P.2d 559, 560-61 (Colo. Ct. App. 1991); *Larsen v. Allstate Ins. Co.*, 857 P.2d 263 (Utah Ct. App. 1993), *cert. denied*, 862 P.2d 1356 (Utah 1993). Conversely, where an insurer correctly relies upon existing case law, a subsequent change in the law does not render the insurer's decision unreasonable. *Leingang v. Pierce County Medical Bureau, Inc.*, 930 P.2d 288 (1997).

¹³¹ See *Richmond*, *supra* note 1, at 119.

¹³² 115 F.3d 230 (3d Cir. 1997)(applying Pa. law).

¹³³ *Id.* at 232-33.

In response to the insurer's argument that it had reasonably relied upon counsel, the court noted:

State Farm argues that it reasonably relied upon its counsel. We would never opine to the contrary, at least for certain advice and representation. Nonetheless, because this point is argued we find it necessary to remark that representation is not an excuse for the insurer's failure to perform its obligations under the policy it issued to the insured. Here, State Farm's attorney would not even answer his phone calls. With admittedly clear liability, serious injuries and [the insured] on welfare because he could no longer work, it was incumbent upon State Farm to do more. And because counsel for the insureds cannot simply make an 'end-run" around the insurer's attorney to deal directly with the insurer, the insurer may not hide behind this relationship to argue that it reasonably ignored its obligations under the insurance policy to its insureds, one of which is to pay them compensation if injured. Otherwise, an insurer could simply hire counsel, bury its head in the sand, pay when ordered to so, retain the use of the insured's money in the meantime, and escape without adverse consequences.¹³⁴

Likewise, in *Walz v. Fireman's Fund Insurance Co.*¹³⁵ the insured avoided summary judgment on the issue of bad faith because the insurer's attorney had not consulted prevailing case law when denying coverage. The attorney's mistake was compounded by the fact that he had failed to review a critical case even after the insured's attorney had brought it to his attention.¹³⁶

Klinger and *Walz* highlight the need for an insurer to retain coverage counsel who will be responsive, both to the insured and the insurer. One suspects that the court in *Klinger* might not have viewed the argument that the insurer had reasonably relied upon counsel so harshly if the insurer had reacted more quickly and more decisively to its counsel's apparent unwillingness to communicate the status of the case or even to return telephone calls to his own client. *Klinger* suggests that it is not enough for an insurer to state it reasonably relied upon counsel.: the insurer must reasonably rely upon reasonable counsel.

C. Discovery Issues

In litigation regarding bad faith, the insured will almost certainly seek to obtain as much information from the insurer as possible concerning the handling of the claim giving rise to the alleged bad faith, as well as any other claims of a similar nature that have been handled by the insurer. If a court is inclined to allow a "fishing expedition," the insurer will face not only increased litigation expense (for both the production and litigation related to

¹³⁴ *Id.* at 234 n. 2.

¹³⁵ 556 N.W.2d 68 (S.D. 1996).

¹³⁶ *Id.* 556 N.W.2d at 70-72.

the production), but also the prospect that the insured in a broad review may find a mistake or inconsistency of approach that will provide fodder for a jury.

Since attorneys are quite often employed to handle the adjustment of claims, an insurer will often invoke attorney-client privilege or work product doctrine in response to discovery requests as to documents in the insurer's or the insurer's counsel's claims file, or information regarding reserves.

In *Parker v. Southern Farm Bureau Casualty Insurance Co.*¹³⁷ the insured obtained summary judgment against an insurer for wrongful denial of a claim based upon invalid cancellation of his policy. Despite the wrongful denial, the insurer obtained summary judgment on the issue of bad faith. The insured sought to reverse summary judgment on the issue of bad faith on appeal and based his argument in part upon the trial court's failure to allow him to obtain full discovery concerning the issue of bad faith. The insured sought to obtain notice of cancellation information for twenty other insureds whose policies had been canceled and four pages from the insurer's claim file that had been withheld after an *in camera* inspection.¹³⁸

The Arkansas Supreme Court upheld the ruling of the trial court in favor of the insured as to coverage and in favor of the insurer as to bad faith. With respect to discovery, the decision provides several useful precepts. First, the court noted the general principle that the trial court has wide discretion with respect to discovery.¹³⁹ This may, of course, work to the benefit of either insureds or insurers, depending upon the judge's view of the world; but it is important for insurers to keep in mind that the outcome with regard to the invocation of a privilege may vary widely from one forum to another.

More importantly, in this case the judge was persuaded to disallow production of cancellation information as to other insureds. Although the insurer argued that the production of the notices would violate the right of privacy of the other insureds, the Arkansas Supreme Court did not use this as a basis for affirming the trial court's decision to disallow production of the cancellation notices. Indeed, it would appear that the privacy issues could easily have been handled simply by redacting the name and address of the persons listed on the notice of cancellation.¹⁴⁰ Instead, the court made note of two factors. First, the insured had been provided sufficient information as to the insurer's policies as to cancellation through document production and

¹³⁷ 935 S.W.2d 556 (Ark. 1996).

¹³⁸ *Id.* at 557-61.

¹³⁹ *Id.* at 560.

¹⁴⁰ Although one suspects that the insured's counsel may have wished to delve further into the matter by contacting these parties and may not have been satisfied with redacted copies of the notices.

the deposition of several employees of the insurer. Second, the court noted that the requests for cancellation notices sought production of notices provided after the alleged bad faith had occurred. The insurer's cancellation activities after the alleged bad faith were irrelevant because the facts supporting bad faith must exist prior to the filing of the action.¹⁴¹ For the same reason, the insured's attempt to base his bad faith claim upon the insurer's litigation conduct failed.¹⁴²

The court in *Parker* also upheld the trial court's decision to withhold from production four pages of notes from the insurer's claim file, on the basis of the work product doctrine. The notes reflected the conversations of the insurer's representative, presumably counsel, with the insured's counsel. The trial court would not compel production of the notes because the notes reflected the insurer's legal theories concerning the insurer's defense to the suit, which was then being threatened by the insured's counsel.¹⁴³

Not all courts are as willing as the Arkansas Supreme Court to prohibit an insured from using the insurer's post-litigation conduct as evidence of bad faith. In *First National Bank of Louisville v. Lustig*,¹⁴⁴ the insured's bad faith claims were severed from the coverage litigation. With respect to the issue of bad faith, the court allowed discovery of the insurer's reserve information and allowed the scope of that discovery to include post-litigation reserve information because the duty of good faith to the insured did not cease as the result of the litigation. The court noted that "facts may develop during litigation on the underlying claim which would cause a reasonable insurer to adjust its reserves. An insurer's response to those facts is relevant to its state of mind and alleged bad faith."¹⁴⁵

The *Lustig* court relied in part upon *White v. Western Title Insurance Co.*,¹⁴⁶ in which the California Supreme Court ruled that although evidence of the insurer's settlement offers could not be considered evidence of the insurer's coverage liability, such evidence could be considered proof of bad

¹⁴¹ *Id.*

¹⁴² *Id.* at 562.

¹⁴³ *Id.* at 561. Note, however, that it is not clear whether the Arkansas Supreme Court agreed with the trial court's view that such items are work product, since the ruling was affirmed in part because the insured had mistakenly addressed the issue as one of the attorney-client privilege, rather than the work product doctrine.

¹⁴⁴ See *First Nat'l Bank of Louisville v. Lustig*, Nos. Civ. A 87-5488 and 88-1682, 1993 WL 411176 at *1 (E.D. La. Jan 25, 1993)(minute entry), explaining that the trial for coverage and bad faith were to be handled in separate phases and that the court would consider the relevance of evidence separately as to each phase.

¹⁴⁵ *Id.* at *2.

¹⁴⁶ 710 P.2d 309 (Cal. 1985), *reh'g denied* (Feb. 14, 1986).

faith, if the evidence indicated that the insurer had persisted in its denial of coverage after the litigation commenced.¹⁴⁷

A later ruling in *First National Bank of Louisville v. Lustig* dealt with discovery of information with respect to other claims made by policies issued by the insurer, including claims that had involved bad faith. The court did not require the production of actual claims files but did require the insurer to produce "bad faith claim history files" which it maintained for a period of almost ten years, and to identify all bad faith claims involving underlying claims in excess of \$5 million for the same period.¹⁴⁸

In *Finkbohner v. Principal Mutual Life Insurance Co.*¹⁴⁹ an insurer had some success in avoiding production of documents related to claims other than the one at issue. The insured had sought information concerning (1) "claims" of bad faith without suit, (2) suits alleging bad faith, and (3) denial of coverage as to other insureds involving the coverage at issue in its own case. The trial court denied the requests as overly broad, unduly burdensome, and not reasonably calculated to lead to the discovery of admissible evidence.¹⁵⁰

The Alabama Supreme Court affirmed the trial court ruling that disallowed the insured's request for information as to all bad faith "claims" or as to all other claims regarding the same coverage language but reversed as to the information relating to prior bad faith litigation. The court found that, although the insurer could readily provide information as to litigation regarding bad faith, it would be overly burdensome to make it review each of its claim files to see whether the insured had made a statement that could be viewed as a threat of a bad faith claim. As to the information concerning coverage, the court did not view the information as probative of the issue of bad faith because the issue in the case before it involved a conflict between the certificate issued to the insured and the coverage language in the policy. Thus, other denials based upon the language in the policy would not be of probative value.¹⁵¹

The foregoing cases illustrate that an insurer may not always succeed in its attempt to limit discovery responses based upon privilege. In addition, an insurer may be required to produce documents relating to other claims or its general approach to claims. Accordingly, an insurer and its counsel must exercise caution and discretion in deciding what thoughts and impressions

¹⁴⁷ *Id.* at 885-89. See also ASHLEY, *supra* note 1, at § 5A-06, for additional consideration of *White* and the issue of post litigation conduct as proof of bad faith.

¹⁴⁸ *Id.* at *1-*2.

¹⁴⁹ 682 So.2d 409 (Ala. 1996).

¹⁵⁰ *Id.* at 411-12.

¹⁵¹ *Id.* at 412-14.

should be documented in the claims file or incorporated into claims manuals.¹⁵² Once matters are included in a file, it may not be possible to remove them.¹⁵³

An insurer should certainly assume that an insured claiming bad faith will seek as much claim and reserve information as possible, including such information as to unrelated claims. An insurer is probably safest to assume that anything in its claims files may need to be shared with the insured in the event of litigation, although an insurer will certainly resist this result to the extent permitted under applicable law.

D. Additional Fidelity Insurance Case Law

There are a number of decisions regarding the alleged bad faith of fidelity insurers rendered during the present decade that do not fit neatly within the preceding categories but nonetheless merit brief discussion.

1. No Bad Faith Despite Incorrect Denial

Three recent decisions involving fidelity insurers stand for the general proposition that an incorrect denial of coverage does not establish bad faith.¹⁵⁴ In *Stop & Shop Cos., Inc. v. Federal Insurance Co.*¹⁵⁵ the insured sought coverage under a commercial crime policy for \$12.5 million in funds lost in connection with the bankruptcy of an entity employed by the insured to invest

¹⁵² See, e.g., *Glenfed Development Corp. v. Superior Court*, 62 Cal. Rptr. 2d 195 (1997)(production of claims manuals required).

¹⁵³ See *State Farm Fire and Cas. Co. v. Superior Court*, 62 Cal. Rptr. 2d 834 (1997)(testimony of insurer's claims personnel indicating that personnel had been advised to destroy old claim files and out-of-date claims manuals in order to avoid production in future bad faith litigation was sufficient to establish that information and testimony subject to attorney-client privilege would need to be produced pursuant to crime/fraud exception to privilege).

¹⁵⁴ As to first-party insurance generally, see, e.g., *Tucker v. State Farm Fire and Cas. Co.*, 981 F. Supp. 461 (S.D. Tex. 1997)(although arson by insured would remain for trier of fact, insurer obtained summary judgment on bad faith); *Gregg v. Allstate Ins. Co.*, 126 F.3d 1080 (8th Cir. 1997)(although insurer could not prove insured's alleged misrepresentation of loss history and arson, bad faith claim properly dismissed by trial court); *United States Fid. & Guar. Co. v. King Enterprises, Inc.*, 982 F. Supp. 415 (N.D. Miss. 1997)(in declaratory judgment action seeking to establish arson, insurer obtained summary judgment on bad faith before question of coverage was decided); *Bush v. Ford Life Ins. Co.*, 682 So. 2d 46 (Ala. 1996)(insurer obtained summary judgment on bad faith without apparent consideration of whether denial based on misrepresentation in insurance application was correct).

¹⁵⁵ 946 F. Supp. 99 (D. Mass. 1996), *rev'd on other grounds*, 136 F.3d 71 (1st Cir. 1998).

and later remit funds for the payment of payroll taxes.¹⁵⁶ The insurer denied coverage because in its view the loss (1) was not a "direct" loss, (2) did not constitute a "wrongful abstraction" and (3) was excluded because it was caused by the criminal act of an "authorized representative" of the insured.¹⁵⁷

The insured disagreed and filed suit, seeking recovery of the loss and an award of attorney's fees for bad faith. The insured relied strongly upon a prior decision as to the same facts and the same coverage in California, in a suit brought by other customers defrauded by the same entity. The insurer, however, argued that Massachusetts law should control. Significantly, a Massachusetts court had ruled that there was no coverage under a similar policy issued by a different insurer to yet another client of the entity that had defrauded Stop & Shop.¹⁵⁸

The district court chose not to defer to the prior ruling under California law and ruled instead that the insured was entitled to coverage. Although Massachusetts precedent appeared favorable to the insurer's position, the court ruled that the policy at issue in the prior Massachusetts case was materially different from the policy issued by the insurer to Stop & Shop. Despite its loss on the issue of coverage, the insurer obtained judgment on the pleadings as to bad faith. The court noted that it had been reasonable for the insurer to dispute coverage, given the complexity of the coverage issues and the existence of prior Massachusetts precedent.¹⁵⁹

In *First Dakota National Bank v. St. Paul Fire & Marine Insurance Co.*¹⁶⁰ the court found that an insurer's denial was based upon "legitimate" defenses, even though the court disagreed with the insurer's decision to deny. The case involved a loss resulting from the diversion of funds from the insured by several bank officials, each of whom had pled guilty to the federal criminal violations.¹⁶¹ The insurer had denied coverage based upon several

¹⁵⁶ *Id.* at 102-04. The entity had paid the \$12.50 to tax authorities on behalf of the insured after the insured discovered that certain tax payments had not been made on its behalf. After other clients of the entity learned of a scheme by executives of the entity to divert funds, the entity was placed into involuntary bankruptcy, and later the insured was required to return the \$12.50 in payments made by the entity on its behalf, because a bankruptcy court ruled that the payments were voidable preferences.

¹⁵⁷ *Id.* at 101.

¹⁵⁸ *Id.* at 107-08.

¹⁵⁹ *Id.* at 110. The insurer appealed the ruling to the First Circuit, and the insured sought a cross-appeal of the denial of its bad faith claim. The insurer prevailed on the question of coverage on appeal, and because the insurer's denial was deemed to have been correct, the First Circuit saw no reason to reconsider the district court's dismissal of the insured's bad faith claim. *Id.*, 136 F.3d 71 (1st Cir. 1998).

¹⁶⁰ 2 F.3d 801 (8th Cir. 1993).

¹⁶¹ *Id.* at 804.

defenses: the untimeliness of notice and proof of loss, the insured's failure to establish manifest intent as required under the bond, the lack of a director's action in the requisite capacity of an "employee," and the insured's ratification of alleged dishonest acts.¹⁶²

As to a substantial portion of the loss, the court found that the insured's denial of coverage had been incorrect. Nevertheless, the court would not award attorneys' fees to the insured because the insurer's defenses did not constitute "vexatious or unreasonable" behavior under South Dakota law. The court viewed the coverage issues as challenging, and it noted further that the jury in the underlying trial had found for both parties as to different issues.¹⁶³

*Adair State Bank v. American Casualty Co. of Reading, Pennsylvania*¹⁶⁴ involved a check-kiting scheme of the insured's chairman and controlling stockholder. The chairman was able to extend and increase the amount of the kite for about ten months, with the aid of three bank employees. The insurer denied coverage based upon the discovery of the scheme near the outset by the three employees. If discovery occurred at the time the three had learned of the kite, it would have triggered termination under the bond for subsequent losses and would have rendered the insured's notice untimely under the requirements of the bond.¹⁶⁵

The insured sought damages for breach of contract, breach of the duty of good faith and fair dealing, and attorneys' fees under the Oklahoma Insurance Code. The question of coverage turned upon the issue of imputation of the knowledge of the three employees to the insured itself. This issue further turned upon whether the employees could be deemed to have acted in collusion with the chairman. Both at trial and on appeal, the insured prevailed in establishing that discovery by the employees did not constitute the insured's discovery. However, the insured did not convince either court that it was entitled to damages for bad faith.¹⁶⁶

The insured argued that the insurer had failed to investigate the claim properly, both because (1) the insurer's management of claims in general predisposed it to deny coverage, and (2) because the investigation of the insured's claim in particular was not timely and not sufficiently thorough to disclose facts that supported coverage.¹⁶⁷ Although the Tenth Circuit cited the standard for the tort of bad faith in Oklahoma as being a relatively low

¹⁶² *Id.* at 805-11.

¹⁶³ *Id.* at 811.

¹⁶⁴ 949 F.2d 1067 (10th Cir. 1991).

¹⁶⁵ *Id.* at 1071-73.

¹⁶⁶ *Id.* at 1071-72, 1076.

¹⁶⁷ *Id.* at 1076.

threshold of proof that denial was "unreasonable," the court also cited precedent clarifying that denial is not unreasonable where legitimate disputes exist as to matters such as insurable interest, extent of coverage, cause of loss, amount of loss or breach of policy conditions. In those circumstances, an insurer's resort to judicial forum is not per se bad faith.¹⁶⁸

The Tenth Circuit further rejected the insured's complaints as to the timeliness of the insurer's response to the proof of loss, in light of a requirement under the Oklahoma Insurance Code that an insurer respond to proof of loss within ninety days. The insurer's response had been provided within thirty days of the insurer's receipt of the proof of loss. As to the investigation of the claim, the court did note that the facts of the case suggested that the insurer's general method of investigation and specific investigation as to the case at issue were problematic, but that the facts as pleaded did not rise to the level of bad faith.¹⁶⁹

Last, the court reviewed the issue of attorneys' fees. After trial, the district court had awarded \$250,000 in attorneys' fees to the insured, under an Oklahoma statute that provided attorneys' fees are "allowable" for the prevailing party in a coverage dispute. The district court had interpreted this provision as making the award of fees mandatory. On appeal the insurer argued that the language of the statute was intended to make the award of fees a matter of the court's discretion. In addition, the insurer argued that the fees would be excluded under the bond since the fees were expended to determine the existence of a covered loss.

The Tenth Circuit agreed with the insurer's interpretation of the fee statute as allowing the award of fees on a discretionary basis, but it disagreed with the insurer's interpretation of the exclusion of coverage for fees under the bond. The court ruled that the fees expended to determine the extent of the loss were distinct from the fees expended to determine the amount of coverage.¹⁷⁰ The court remanded the issue of fees to the district court for review in light of the discretionary nature of the statute and in view of additional issues relating to a portion of the fees claimed for one of the two law firms that may have volunteered to provide legal support without payment.¹⁷¹

¹⁶⁸ *Id.* at 1076-77, citing *Christian v. American Home Assurance Co.*, 577 P.2d 899, 901, 905 (Okla. 1977).

¹⁶⁹ *Id.* at 1077 n.4.

¹⁷⁰ *Id.* at 1078. Note that this conflicts with the holding in *Beverly Bancorporation v. Continental Ins. Co.*, discussed *supra* at text accompanying notes 66-70.

¹⁷¹ *Id.* at 1078-79.

2. Denial Without Discussion of Bad Faith Principles

Perhaps as an indication that bad faith is often simply tacked on to coverage claims, there are several additional decisions from 1990 to date involving fidelity insurance in which courts dismissed insureds' bad faith claims without discussion, upon a ruling in favor of the fidelity insurer.¹⁷² Since coverage issues under fidelity insurance recur with some frequency, these cases may prove of some benefit to fidelity insurance counsel who may need to respond to an allegation of bad faith in the context of a similar coverage dispute.

IV. CONCLUSION

Although insurers may not experience, in the next decade, any change as profound as the proliferation of bad faith remedies during the past several decades, the continued evolution of the body of common law and statutes concerning bad faith appears to be certain, as various states continue to consider the appropriate cause of action for bad faith, the appropriate standards for the cause of action, and the interplay between claims handling statutes and the common law. In addition, courts will need to continue to address issues relating to the litigation of bad faith claims, especially concerning the correct balance of the rights of the parties with respect to discovery.

Certainly, for these reasons, continued vigilant monitoring of bad faith law is essential for the insurer, both to avoid susceptibility to these claims and to mount the best possible defense to them. In addition, it is clear that insurers must keep a watchful eye over their own personnel and counsel retained to handle claims. This task becomes all the more challenging when the insurer must consider the possibility that it may need to share its critique of these persons with opposing counsel or even a jury, if ordered to produce a broad range of documents in a bad faith case.

¹⁷² See *Community Savings Bank v. Federal Ins. Co.*, 960 F. Supp. 16 (D. Conn. 1997)(after insurer prevailed on questions of late notice and termination of coverage, insured conceded that it had no bad faith claim); *United States Fid. & Guar. v. Planters Bank & Trust Co.*, 77 F.3d 863 (5th Cir. 1996)(applying Mississippi law)(in affirming summary judgment for insurer concerning coverage, no discussion of whether trial court's dismissal of bad faith was correct, although judgment was affirmed); *Insurance Co. of N. Am. v. Liberty United Bancorp, Inc.*, 1998 WL 109971 (6th Cir. Mar. 3, 1998)(applying Kentucky law)(in affirming trial court ruling in favor of insurer concerning lack of requisite manifest intent, no discussion of bad faith, although ruling affirmed); *Willow Mgt Co. v. American States Ins.*, 1995 WL 22862 (N.D. Ill. Jan 3, 1995)(in granting motion to dismiss claim, court rejects insured's adverse domination argument for tolling the discovery period; bad faith claim also dismissed, but without discussion); *Good Lad Co. v. Aetna Cas. & Sur. Co.*, 1995 WL 393964 (E.D. Pa. June 30, 1995)(upon ruling in favor of the insurer regarding coverage, the court assumed that the insured had abandoned its claim under the Pennsylvania Insurance Code for punitive damages, attorneys' fees and costs under the claim, but nevertheless provided an affirmative statement that the insured's request for such damages was denied).

It would be incorrect, nevertheless, to view recent changes in the law of bad faith as moving only toward increasing liability of insurers. While most states provide a cause of action for bad faith in one form or another, most states have not sought to expand these remedies to eliminate the requirement of intentional misconduct. In addition, although courts do not appear likely to embrace comparative negligence principles or a cause of action for reverse bad faith, they have in many instances indicated a willingness to allow the insurer to utilize the insured's misconduct as a defense to bad faith claims.

For fidelity insurers in the wake of *Downey*, as for first-party insurers as a whole, it appears that the bad faith claim is almost a routine addition to coverage suits. In spite of this fact, outcomes for fidelity insurers are generally favorable. There have been very few examples of damage awards for bad faith against fidelity insurers after *Downey*, and there are no large punitive damage awards in the reported decisions.

The success of fidelity insurers in avoiding bad faith awards may be attributed to several factors. Fidelity insurers, like the insurance industry at large, have likely reacted to the increased potential for bad faith claims by review of claims handling practices and modification, where necessary. Furthermore, increased competition among insurers in current soft market conditions may have also caused fidelity insurers to become more service oriented, less inclined to tolerate lax claims handling, and less inclined to test their defenses in court because of the possible adverse effect in the marketplace. Finally, although courts have had a tendency to overlook the differences between insurance provided to a consumer market and insurance provided to more sophisticated and demanding commercial insureds, some courts seem to have recognized that fidelity bond claims are by nature often factually and legally complex and are therefore not as simply investigated or resolved as typical fire, medical or automobile claims. This has further been recognized in at least some states by the exemption of fidelity insurance from unfair claims practices statutes.

Nevertheless, fidelity insurers cannot afford to be complacent about the risk of bad faith claims. First, the varied approaches taken by different states and the likelihood of additional change in the law, whether instituted legislatively or judicially, make necessary the insurer's continued review of the law and its evaluation of its claims handling practices in light of any changes in the law. Moreover, although fidelity insurers appear to have avoided large bad faith awards in this decade, the stakes are still higher than they used to be. A mistake in the claims handling process need not rise to the level of actual bad faith to increase the cost of settlement of a case, and even where an insurer is inclined to stand its ground on a claim of bad faith, defense of it may be costly. If an insured preserves a bad faith claim beyond the initial pleading stage, the insured may then increase the cost for the insurer by pro-

pounding additional discovery and adding another dimension to the trial of the case. The insurer should devote at least as many resources to prevention of claims for bad faith as to its defense after a preventable mistake has been made.

APPENDIX A

STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
ALABAMA	YES Blackburn v. Fidelity and Deposit Co. of Maryland, 667 So.2d 661 (Ala. 1995) <i>Follows Anderson</i>	ALA. CODE § 27-12-24 (Michie 1971)	NO	NO Farlow v. Union Central Life Ins. Co., 847 F.2d 791 (11th Cir. 1989)	
ALASKA	YES State Farm v. Nicholson, 777 P.2d 1152 (Alaska 1989) <i>Follows Gruenberg</i>	ALASKA STAT. § 21.36.125 (Michie 1976)	NO	NO O.K. Lumber Co. v. Providence Washington Ins. Co., 759 P.2d 523 (Alaska 1988)	
ARIZONA	YES Hawkins v. Allstate Ins. Co., 733 P.2d 1973 (Ariz. 1987) <i>Follows Anderson</i>	ARIZ. REV. STAT § 20-461 (1990)	NO	NO Ariz. Rev. Stat. § 20-461D (1990)	

continued

STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
ARKANSAS	YES Aetna Cas. & Sur. Co. v. Broadway Arms Corp., 664 S.W.2d 463 (Ark. 1984) Affirmative conduct that is dishonest, malicious or oppressive	ARK. CODE ANN. § 23-66-205 (1959)	NO	PROBABLY NOT The Act says that a private right of action is "not established or extinguished..." ARK. CODE ANN. § 23-66-202. There are no reported cases where an insured brought a claim against an insurer under the Act.	Pursuant to ARK. CODE ANN. § 23-79-208, if fidelity carrier is liable under bond and fails to pay after demand, court may award interest at 12% per annum plus attorneys' fees.
CALIFORNIA	YES Gruenberg v. Aetna Ins. Co. 108 Cal. Rptr. 480, 510 P.2d 1032 (Cal. 1973)	CAL. INS. CODE § 790.03(h) (West 1959)	NO	NO Maradi-Shalal v. Fireman's Fund Ins. Co., 758 P.2d 58 (Cal. 1988)	

continued

STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
COLORADO	YES Travelers Ins. Co. v. Savio, 706 P.2d 1258 (Colo. 1985) See also, COLO. REV. STAT. ANN. § 10-3-1113 (West 1963) <i>Follows Anderson</i>	COLO. REV. STAT. ANN. § 10-3-1104(h) (West 1963)	NO	NO Schnacker v. State Farm Mutual Automobile Ins. Co., 843 P.2d 102 (Colo. Ct. App. 1992)	
CONNECTICUT	YES Grand Sheet Metal Products v. Protection Mutual, 375 A.2d 428 (Super. Ct. 1977) <i>Follows Gruenberg</i>	CONN. GEN. STAT. ANN. § 38a-816 (West 1955)	NO	YES Griswold v. Union Labor Life Ins. Co., 442 A.2d 920 (Conn. 1982)	
DELAWARE	YES Casson v. Nationwide Ins. Co., 455 A.2d 361 (Del. Super. Ct. 1982) <i>Follows Anderson</i>	DEL. CODE ANN. tit. 1.18 § 2304(16) (1953)	NO	YES Anderson v. Nationwide Mutual Ins. Co., 1985 WL 189229 (Del. Super.)	

continued

STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
D.C.	CONFLICT Messina v. Nationwide Mutual Ins. Co., 998 F.2d (1993) discusses the conflict between two district court cases.	D.C. CODE ANN. § 28-3904 (1973)	NO	NO	An insured may maintain a cause of action under the Consumer Protection Procedures Act, D.C. CODE ANN. § 28-3901 (1973)
FLORIDA	NO Allstate Ins. Co. v. Douville, 510 So. 2d 1200 (Fla. Dist. Ct. App. 1987) <i>rev. denied</i> , 519 So. 2d 986 (Fla. 1987)	FLA. STAT. ANN. § 626.9541(1)(i) (West 1976)	NO	YES State Farm v. Laforat, 658 So. 2d 55 (Fla. 1995)	Pursuant to FLA. STAT. ANN. § 627.428, court upon rendering judgment against insurer may award attorneys' fees.
GEORGIA	NO Tate v. Aetna Cas. & Sur. Co. 253 S.E.2d 775 (Ga. App. 1979).	GA. CODE ANN. § 33-6-34 (1981)	YES	NO GA. CODE ANN. § 33-6-37 (1992)	Pursuant to GA. CODE ANN. § 33-4-6, when an insurer refuses to pay in bad faith, the insured is allowed to recover its loss plus not more than 25% of the insurer's and those attorneys' fees incurred in pursuing an action against the insurer.

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
HAWAII	YES The Best Place Inc. v. Penn American Insurance 920 P.2d 334 (Haw. 1996) <i>Follows Gruenberg</i>	HAW. REV. STAT. § 43113-101 (1987)	NO	NO Hunt v. First Insurance Co. of Hawaii, Ltd., 922 P.2d 976 (Hawaii App. 1996)	
IDAHO	YES White v. Unigard Mut. Ins. Co., 730 P.2d 1014 (Idaho 1986) <i>Follows Anderson</i>	IDAHO CODE § 41-1301 (1977)	NO	NO White v. Unigard Mutual Ins. Co., 730 P.2d 1014 (Idaho 1986)	Pursuant to IDAHO CODE § 41-1839, an insured may recover attorneys' fees if insurer fails to pay amount justly due within 30 days of proof of loss.
ILLINOIS	NO Cramer v. Illinois Insur. Exchange Agency, 675 N.E.2d 897 (Ill. 1996)	215 ILL. COMP. STAT. ANN. 5/154.5 (West 1937)	NO	NO Van Vleck v. Ohio Casualty Ins. Co., 128 Ill. App. 3d 959 (1984)	The Illinois Legislature has provided for an award of extra contractual damages in actions involving insurance policies and vexatious or unreasonable delay in Settlement. ILL. REV. STAT. Ch 215 § 5/155(1)

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
INDIANA	YES Erie Ins. Co. v. Hickman, 622 N.E.2d 515 (Ind. 1993) <i>Follows Anderson</i>	IND. CODE ANN. § 27-4-1-4.5 (West 1983)	NO	NO Erie Ins. Co. v. Hickman, 622 N.E.2d 515 (Ind. 1993)	
IOWA	YES Dolan v. Aid Ins. Co., 431 N.W.2d 790 (Iowa 1988) <i>Follows Anderson</i>	IOWA CODE ANN. § 507B.4(9) (1955)	NO	NO Seeman v. Liberty Mutual Ins. Co., 322 N.W.2d 35 (Iowa Sup. Ct.)	
KANSAS	NO Spencer v. Aetna Life & Cas. Ins. Co., 611 P.2d 149 (Kan. 1980)	KAN. STAT. ANN. § 40-2403 (1955)	NO	NO Earth Scientists Ltd. v. United States Fidelity & Guaranty Co., 619 F.Supp. 1465 (D. Kan. 1985)	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
KENTUCKY	YES Curry v. Fireman's Fund, 784 S.W.2d 176 (Ky. 1989) <i>Follows Anderson</i>	KY. REV. STAT. ANN. § 304.12-230 (Baldwin's 1988)	NO	YES FB Insurance Co. v. Jones, 864 S.W.2d 929 (Ky. Ct. App. 1993)	
LOUISIANA	NO Bye v. American Income Life Ins. Co., 316 So. 2d 164 (La. Ct. App. 45h Cir. 1975)	LA. REV. STAT. ANN. § 221214(14) (West 1990)	NO	NO A-1 Nursery Registry, Inc. v. United Teacher Associates Ins. Co., 682 So.2d 929 (La. App. 3rd Cir. 1996)	LA. REV. STAT. § 22120 provides that an insurer owes insured duty of good faith and fair dealing which, if breached, will subject insurer to any damages resulting from such breach. This provision goes on to list five (5) specific acts, any one of which constitutes a breach of the insurer's duty. LA. REV. STAT. § 22658 provides that when insurer's failure to make payment under the policy is arbitrary, capricious or without probable cause, insured is entitled to an additional 10% of amount due plus attorneys' fees.

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
MAINE	NO Marquis v. Farm Family Mutual Ins. Co., 628 A.2d 644 (Me. 1993)	ME. REV. STAT. ANN. tit. 24-A, § 2164-D (1987)	NO	YES Massachusetts Casualty Ins. Co. v. Vanidestine, 980 F.Supp. 556 (D. Maine 1997)	ME. REV. STAT. ANN. tit. 24-A § 2436 provides that insured is entitled to 1.5% interest per month if insurer fails to pay undisputed claim.
MARYLAND	NO Johnson v. Federal Kemper Ins. Co., 536 A.2d 1211 (Md. App. 1988), cert. den. 542 A.2d 844 (Md. 1988)	MD. CODE ANN. INS. § 27-303	YES	NO Johnson v. Federal Kemper Ins. Co., 536 A.2d 1211 (Md. App. 1988), cert. denied 542 A.2d 844 (Md. 1988)	
MASSACHUSETTS	NOT DECIDED	MASS. GEN. LAWS ANN. Ch 176D § 3(9) (West 197)	NO	YES MASS. GEN. LAWS ANN. Ch 93A § 9 (West 1972).	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
MICHIGAN	NO Kewin v. Massachusetts Mut. Life Ins. Co., 295 N.W.2d 50 (Mich. 1980)	MICH. COMP. LAWS ANN § 500.206 (West 1956)	NO	NO Crossley v. Allstate Ins. Co., 400 N.W.2d 625 (Mich. Ct. App. 1986)	MICH. COMP. LAWS ANN. § 500.2006 provides that insured is entitled to 12% interest if insurer fails to timely pay the claim.
MINNESOTA	NO Haagenson v. National Farmers Union, 277 N.W.2d 648 (Minn. 1979)	MINN. STAT. ANN. § 72A.17 (West 1989)	NO	NO Doe v. Norwest Bank Minnesota, 107 F.3d 1297 (8th Cir. 1997)	
MISSISSIPPI	YES Universal Life Ins. Co. v. Veasley, 610 So. 2d 290 (Miss. 1992). Must prove insurer acted with malice or gross negligence or reckless disregard for the rights of others.	MISS. CODE ANN. § 83-5-33 (1972)	NO	NO Protective Service Life Ins. Co. v. Carter, 445 So. 2d 215 (Miss. 1985)	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
MISSOURI	NO Duncan v. Andrew County Mut. Ins. Co., 665 S.W.2d 13 (Mo. Ct. App. 1983)	MO. ANN. STAT. § 375.1000 (West 1991)	YES	NO MO. ANN. STAT. § 375.1000.2 (West 1991)	Pursuant to MO. ANN. STAT. § 375.420 (West 1991), In an action against an insurance company to recover loss under various policies (including fidelity), if there is unreasonable delay or denial, the court may award extra contractual damages measured as a percentage of the Insured's claim.
MONTANA	YES Stephens v. Safeco Ins. Co. of America, 852 P.2d 565 (Mont. 1993). To be bad faith, act must be done without justification and either willful, malicious or oppressive.	MONT. CODE ANN. § 33-18-201 (1977)	NO	YES K-W Industries v. National Surety Corp., 754 P.2d 502 (Mont. 1988)	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT			OTHER STATUTES ADDRESSING BAD FAITH
		UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	
NEBRASKA	YES Braesch v. Union Ins. Co., 464 N.W.2d 769 (Neb. 1991) <i>Follows Anderson</i>	NEB. REV. STAT. § 44-1536 (1991)	NO	NO The Act states that "nothing herein shall be construed to create nor imply a private cause of action for violation of this rule.	NEB. REV. STAT. § 44-359 provides that a court upon rendering judgment against insurer may award attorneys' fees.
NEVADA	YES Pemberton v. Farmers Ins. Exchange, 858 P.2d 380 (Nev. 1993) <i>Follows Gruenberg</i>	NEV. REV. STAT. § 686A.310 (1975)	NO	YES NEV. REV. STAT. § 686A.310(2)	
NEW HAMPSHIRE	NO Lawton v. Great Southwest Fire Ins. Co., 392 A.2d 576 (N.H. 1978) Expands liability beyond traditional contract damages	N.H. REV. STAT. ANN. § 4174 (XV) (1947)	NO	YES After the Insurance Commissioner has made a final finding.	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
NEW JERSEY	YES Pickett v. Lloyd's, 621 A.2d 445 (N.J. 1992) <i>Follows Anderson</i>	N.J. STAT. ANN. § 1729B-4 (West 1975)	YES	NO Pickett v. Lloyd's, 621 A.2d 445 (N.J. 1992)	
NEW MEXICO	YES Chavez v. Chenoweth, 553 P.2d 703 (Ct. App. 1976) <i>Follows Anderson</i>	N.M. STAT. ANN. § 59A-16-20 (Michie 1984)	NO	YES N.M. STAT. ANN. § 59A-16-30 (Michie 1984).	N.M., STAT. ANN. § 39-2-1 provides that an insured that prevails against insurer in first party claim, will be entitled to attorneys' fees if the insurer acted unreasonably.
NEW YORK	NO Halpin v. Prudential Ins. Co., 401 N.E.2d 171 (N.Y. 1979)	N.Y. INS. LAWS § 2601 (McKinney 1975)	NO	NO Rocanova v. Equitable Life Assurance Society of the United States, 612 N.Y.2d 339 (N.Y. Ct. App. 1994)	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
NORTH CAROLINA	YES Dailey v. Integon General Insur. Corp., 331 S.E.2d 148 (N.C. App. 1985) <i>Follows Gruenberg</i>	N.C. GEN. STAT. § 58-63-1 (1949)	NO	NO Horton v. New South Insurance Co., 122 N.C. App. 265 (1996)	Unfair and deceptive practices in the insurance industry are not regulated exclusively through the Unfair Claims Practices Act. Therefore a violation of the Act may constitute a basis for recovery under N.C. GEN. STAT. § 75-1.1. See <i>Horton</i> . N. C. GEN. STAT. § 6-21.1 provides that an insured will be entitled to attorneys' fees if there is an unwarranted refusal to pay and it obtains judgment for \$10,000 or less.
NORTH DAKOTA	YES Corwin Chrysler-Plymouth v. Westchester Fire Ins. Co., 279 N.W.2d 638 (N.D. 1979) <i>Follows Gruenberg</i>	N.D. CENT. CODE § 26.1-04-03 (1983)	NO	YES Dvorak v. American Family Mut. Ins. Co., 508 N.W.2d 329 (N.D. 1993)	
OHIO	YES Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315 (1983) <i>Follows Gruenberg</i>	OHIO REV. CODE § 3901-21 (west 1987), OHIO INS. DEPT. RULE 3901-107(C)	NO	NO Strack v. Westfield Companies, 515 N.E.2d 1005 (Ohio Ct. App. 1986)	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
OKLAHOMA	YES Christian v. American Home Assur. Co., 577 P.2d 899 (Okla. 1977) <i>Follows Gruenberg</i>	OKLA. STAT. ANN. T.36, § 1250 (West. 1986)	NO	NO Walker v. Chouteau Lime Co., Inc., 849 P.2d 1085 (Okla. 1993)	
OREGON	NO Employers' First Ins. Co. v. Love It Ice Cream Co., 670 P.2d 160 (Or. App. 1983)	OR. REV. STAT. § 746.230 (1967)	NO	NO Farris v. United States Fidelity and Guaranty Co., 284 Or. 453 (1978)	OR. REV. STAT. § 742.061 provides that if there is no payment of claim within six months of proof of loss and the insured succeeds in obtaining an award greater than the insurer's last settlement offer, attorneys' fees may be awarded.
PENNSYLVANIA	NO Ambrosio v. Pennsylvania Nat. Mut. Cas. Ins. Co., 431 A.2d 966 (Pa. 1981)	40 PA. CONST. STAT. ANN. § 1171.1 (West 1974) 31 PA. CONS. STAT. Ann. § 146.1 (WEST 1978)	YES	NO Smith v. Nationwide Mutual Fire Ins. Co., 935 F. Supp. 616 (W.D. Pa. 1996)	42 PA. CONS. STAT. § 8371 (Actions on Insurance Policies) provides if court concludes that insurer acted in bad faith, the insured may be awarded interest on its loss from the date it was submitted at prime plus 3%, punitive damages and court costs and attorney fees.

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
PUERTO RICO	YES Event Producers Ins. v. Tyser & Co., 854 F. Supp. 35 (D.P.R. 1993) <i>Follows Anderson</i>	P.R. LAWS ANN. TIT. 26 § 2701 (1977)	NO	NOT DECIDED	
RHODE ISLAND	YES Bibeault v. Hanover Ins. Co., 417 A.2d 313 (R.I. 1980) <i>Follows Anderson</i>	R.I. GEN. LAWS § 27-9.1-3 (1993)	YES	NO Solomon v. Progressive Casualty Ins. Co., 685 A.2d 1073 (R.I. 1996)	R.I. GEN. LAWS § 9-1-33 creates a right of action based upon the insurer's bad faith refusal to pay or settle a claim or failure to perform as agreed under the Policy in a timely manner.
SOUTH CAROLINA	YES Varnadore v. Nationwide Mutual Insurance Co., 289 S.C. 155 (1986) <i>Follows Gruenberg</i>	S.C. CODE ANN. § 38-59-2- (Law Co-op 1952)	NO	NO Bulsa v. GEICO, 39 F.3d 1175 (4th Cir. 1994)	S.C. CODE ANN. § 38-59-40 provides that if an insurer refuses without reasonable cause or in bad faith to pay covered loss within 90 days of demand, the insured is entitled to attorneys' fees.

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
SOUTH DAKOTA	YES In re Certification of Question of Law from United States District Court, 399 N.W.2d 320 (S.D. 1987) <i>Follows Anderson</i>	S.D. CODIFIED LAWS § 58-33-67 (Michie 1986)	YES	YES S.D. CODIFIED LAWS § 58-33-46.1 (1997)	S.D. CODIFIED LAWS § 58-12-3 provides that if there is vexatious delay or refusal to pay claim without reasonable cause, attorneys' fees may be added to the judgment against insurer.
TENNESSEE	NO Chandler v. Prudential Ins. Co., 715 S.W.2d 615 (Tenn. Ct. App. 1986).	TENN CODE ANN. § 56-8-101	NO	NO TENN. STAT. § 56-8-104(8)	Pursuant to TENN. STAT. § 56-7-105, if fidelity carrier refuses to pay under bond within 60 days of a demand and such refusal was not in good faith and resulted in additional damages, the insurer shall be liable to pay to the insured no more than 25% of its liability. If the refusal was vexatious and without reasonable cause, the insured will also be entitled to attorneys' fees up to 12.5% of its liability.
TEXAS	YES Universe Life Ins. Co. v. Giles, 950 S.W.2d 48 (Tex. 1997) Adopts "reasonably clear" standard.	TEX. INS. CODE ANN. § 21.21 (West 1951)	NO	YES TEX. INS. CODE ANN. § 21.21-16(a) (West 1951)	

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
UTAH	NO Beck v. Farmers Ins. Exchange, 701 P.2d 795 (Utah 1985) Expands Contract Damages	UTAH CODE ANN § 31A-26-303 (1953)	NO	NO UTAH CODE ANN § 31A-26-303(5)(19)	
VERMONT	YES Bushey v. Allstate Ins. Co., 670 A.2d 807 (Vt. 1995) <i>Follows Anderson</i>	VT. STAT. ANN. tit. 8 § 4724(9) (1967)	NO	NO Wilder v. Aetna Life & Cas. Ins. Co., 140 Vt. 16, 433 A.2d 309 (1981).	
VIRGINIA	NO Levine v. Selective Ins. Co. of America, 462 S.W.2d 81 (Va. 1995) Expands contract damages	VA. CODE ANN. § 38.2-510 (Michie 1950)	NO	NO A&E Supply Co., Inc. v. Nationwide Mutual Fire Ins. Co., 798 F.2d 669 (4th Cir. 1986)	VA. CODE ANN. § 38.2-209 provides that if insurer denies coverage or fails to make payment not in good faith, attorneys' fees may be awarded.

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

		UNFAIR CLAIMS PRACTICES ACT			
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
WASHINGTON	YES Industrial Indemnity Co. of the Northwest v. Kallevig, 792 P.2d 520, 7 A.L.R. 5th 1014 (Wash. 1990) <i>Follows Gruenberg</i>	WASH. REV. CODE AN. §48.30.010 (West 1947) Adopted Administratively WASH. ADMIN. CODE § 284-30-330 (1987)	NO	NO	Although there is no private right of action under the Unfair Claims Act, an insured may bring a cause of action under the Consumer Protection Act. WASH. REV. CODE ANN. § 19.86.0101 et. seq. (1947)
WEST VIRGINIA	NO McCormick v. Allstate Ins. Co. 475 S.E.2d 507 (W.Va. 1996) But court permits recovery of broad range of damages	W. VA. CODE § 33-11-1 (Michie 1957)	NO	YES McCormick v. Allstate Ins. Co., 475 S.E.2d 507 (W. Va. 1996)	
WISCONSIN	YES Anderson v. Continental Ins. Co., 271 N.W.2d 368 (Wis. 1978)	Adopted Administratively WIS. ADMIN. CODE § 6.11 (1971)	NO	NO Kranzush v. Badger State Mutual Ca. Co., 103 Wis. 2d 56, 307 N.W.2d 256 (1981)	WIS. STA. ANN. § 628.46 provides that if insurer fails to promptly pay claim (within 30 days of proof of loss) the insured is entitled to 12% interest on any "overdue" payment.

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STATUTORY AND COMMON LAW CAUSES OF ACTION FOR BAD FAITH

UNFAIR CLAIMS PRACTICES ACT					
STATE	FIRST PARTY BAD FAITH CAUSE RECOGNIZED	UNFAIR CLAIMS PRACTICES ACT CITATION	FIDELITY INSURER EXCLUDED?	PRIVATE CAUSE OF ACTION ALLOWED?	OTHER STATUTES ADDRESSING BAD FAITH
WYOMING	YES McCullough v. Golden Rule Ins. Co., 789 P.2d 855 (Wyo. 1990) <i>Follows Anderson</i>	WYO. STAT. ANN. § 26-13-124 (Michie 1986)	NO	NO Herrig v. Herrig, 844 P.2d 487 (Wyo. 1992)	