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Bad Faith Overview -

Not Just A Question of Whether The Insurer Pays

Presented to Aon Claims Advocates

Aon

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What is Bad Faith?

Breach of the implied covenant of good faith and fair dealing.

- **First Party Claims**: Refusal to pay a claim without a reasonable basis, or failing properly to investigate the claim in a timely manner.
- **Third Party Claims**: Wrongful failure to defend, indemnify or settle a claim within limits without a reasonable basis, or failure properly to defend or investigate.

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What is Bad Faith?

- Breach of the implied covenant of good faith and fair dealing. *Communale v. Traders & General Ins. Co., 50 Cal. 2d 654* (1958).
- Requires that the insurer refrain from doing anything to prevent the insured from receiving the full benefits of the contract. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809 (1979).

➢ Insurer should not hold its own interests over the interests of the Insured.

- Duty on the insurer to accept a reasonable settlement offer within limits after liability is reasonably clear and where there is a "substantial likelihood of a recovery in excess of those limits.“ *Johansen v. California State Auto Inter-Ins. Bureau, 1*5 Cal. 3d 9 (1975).

California Bad Faith Law

Statutory and Common Law

- Statutes:

  Unfair Claims Practices Act (1972), Cal. Ins. Code § 790.03. Knowingly committing or performing with such frequency as to indicate a general business practice of any of the following unfair claims settlement practices:

  - Deceptive claims practices
  - Misrepresenting pertinent facts or coverage provisions to avoid paying
  - Improper conduct during the litigation (*cf. White v. Western Title* waivers)
  - Unreasonable delay in responding or resolving a claim
  - Failure to investigate
  - Using improper standards
  - Compelling an insured to contribute to settlement
  - Abusive or coercive tactics to settle a claim
  - Failing to affirm or deny coverage within a reasonable time after proof of loss or lawsuit
  - Not attempting to effectuate prompt, fair and equitable settlement after liability is reasonably clear
  - Attempting to settle a claim for less than a reasonable man would believe appropriate
  - Compelling insureds to file litigation to obtain coverage benefits

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What is Bad Faith?

So multiple critical, separate issues:

- Duty to Defend
- Duty to Indemnify
- Duty to Investigate
- Duty to Settle

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Duty to Defend

Duty to Defend

- Separate and distinct from duty to indemnify
- Broader than duty to indemnify – potentially covered
- Extends to "groundless, false or fraudulent" claims
- Duty at time of notice
  - Duty can also arise later – important to consider during suit
  - Pretender defense cost issues
- Duty to Defend in Mixed Actions
  - CGL, defend entire action
  - Some policies D&O/E&O, allocation issues (not mathematical)
  - Right to recoup costs (*Buss vs. Superior Ct*) ***if*** insurer reserves the right to recover in some states; bad faith in others; burden of proof

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Duty to Investigate

Duty to Investigate

Statutes, policy language, internal claims handling policies, and common law

- Insuring Agreement (“We may, at our discretion, investigate any ‘occurrence’ …” or personal and advertising injury offense). ISO Form CG 00 01 10 01
- Timing: as quickly as possible following notice and espec. for third party claims where failure to respond may prejudice
- Evaluating the investigation:
  - “Four Corners” states (CO, CT, FL, ME, MT, NM, OK, PA); “Eight Corners” states (IL, MS, NC, TX); and Extrinsic Evidence states (AL, CA, MD, MN, MO, NY – if supports)
  - Was the investigation reasonable?
  - Was purpose to find bases for coverage vs. grounds to deny?

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Duty to Settle

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Duty to Settle

- The rule is rooted in conflict of interest principles:

  A "genuine and immediate" conflict arises between an insurer and its insured when a claimant offers to settle an excess liability exposure for an amount within the policy limit. *Merritt v. Reserve Ins. Co*., 34 Cal. App. 3d 858, 870 (1973).

- Duty depends on whether the settlement demand is reasonable:

  "The duty of good faith and fair dealing does not impose a categorical obligation to accept a settlement demand regardless of cost." *Continental Cas. Co. v. United States Fid. & Guar. Co.,* 516 F.Supp. 384, 389 (N.D. Cal. 1981). The duty of good faith requires an insurer "to settle *in an appropriate case."* *Walbrook Ins. Co., Ltd. v. Liberty Mut. Ins. Co.*, 5 Cal. App. 4th 1445 (1992).

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Duty to Settle

- Whether a settlement offer is reasonable depends on the information the insurer knows at the time of the demand. *KPFF, Inc. v. California Union Ins. Co.*, 56 Cal. App. 4th 963, 973 (1997).
- Reasonableness is usually a question of fact. *Hodges v. Standard Accident Ins. Co*., 1989 Cal. App. 2d 564, 574 (1961); *see also Walbrook,* 5 Cal. App. 4th at 1457 (where both parties had "colorable positions," issue was one of fact for jury); but see *Samson v. Transamerica Ins. Co*., 30 Cal. 3d 220, 243 (1981) (reasonableness of insurer's handling was question of law where insurer rejected an offer within policy limits after entry of an excess judgment against the insured).

Duty to Settle

- Duty to consider reasonableness ***without* regard to any coverage defenses.** *Johansen v. California State Auto. Ass'n Inter-Ins. Bureau*, 15 Cal. 3d 9, 16 (1975).
- Insurer cannot sit back and ignore plaintiffs' demands or an opportunity to settle. *Reid v. Mercury Ins. Co*., 220 Cal. App. 4th 262, 278 (2013) (liability arises for insurer "when a claimant clearly conveys to the insurer an interest in discussing settlement but the insurer ignores the opportunity to explore settlement possibilities to the insured's detriment, or when an insurer has an arbitrary rule or engages in other conduct that prevents settlement opportunities from arising.").

Genuine Dispute ≠ Bad Faith

Genuine Dispute Doctrine – is coverage "fairly debatable"

- *Chateau Chamberay Homeowners Assn. v. Associated Int'l Ins. Co.*, 90 Cal. App. 4th 335 (2001) (Insurer and insured had a "genuine dispute" as to the portion of loss that was covered and the proper amount of covered loss, so insurer could not be found to have acted unreasonably or without proper cause for its adjustment activities and delay; as a matter of law, insurer not liable for bad faith).
- "Boy Who Called Wolf." W*ilson v. 21st Century Ins. Co.*, 42 Cal. 4th (2007) (21 year old seriously injured by drunk driver)*; Brehm v. 21st Century Ins. Co.*, 166 Cal. App. 4th 1224 *(2008)* (demurrer).
- No coverage in the first instance?
- Advice of counsel defense

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Duty to Settle – Frequently Applied Factors

- The strength of the third-party claimant's (liability and damages).
- The nature of the insurer's investigation to determine the policyholder's liability.
- The likelihood of an excess/adverse verdict.
- Defense counsel's recommendations.
- Whether the insurer rejected the advice of its attorney or agent.
- Was the policyholder was informed of settlement demands/offers.
- Did the policyholder demand that the insurer settle within limits.

Duty to Settle – Frequently Applied Factors

- Did the insurer consider any offer by the policyholder to contribute to settlement.
- Attempts by the insurer to induce policyholder contributions.
- The financial risk to the insurer and policyholder if the underlying action does not settle.
- Whether the policyholder misled the insurer as to the facts, so as to induce it not to settle.
- Other factors that establish or negate bad faith.

State Farm Mut. Auto. Ins. Co. v. Mendoza, No. CIV-02-1141-PHX-ROS, 2006 WL 44376, at *18 (D. Ariz. Jan. 5, 2006), reconsideration granted in part, *State Farm Mut. Auto. Ins. Co. v. Mendoza*, 432 F. Supp. 2d 1017 (D. Ariz. 2006); *O'Neill v. Gallant Ins. Co*., 329 Ill. App. 3d 1166, 769 N.E.2d 100 (2002); *Jessen v. O'Daniel*, 210 F. Supp. 317, 326-27 (D. Mont. 1962), *aff'd sub nom*. *Nat'l Farmers Union Prop. & Cas. Co. v. O'Daniel*, 329 F.2d 60 (9th Cir. 1964).

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When to Consult with Coverage Counsel?

- Early “hallway” consultations
- Complex coverage position letters
- Responses to RoRs (intentional conduct)
- Refusals to defend
- Inadequate allocations
- Appointment of Counsel/independent counsel issues
- Changes in underlying case (claims/damages/etc.)
- Reviews of coverage position letters (“injunctive”/ inadequate reserves)
- Settlement Offers/before Conferences/ Mediations
- For Aon’s files

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When should you consult with Coverage Counsel?

- Oreo sandwich approach, and
- “Setting up” settlements
  - Defense counsel status reports
  - Responses to hints of hard line positions
  - Late supplemental coverage position letters
  - Responses to plaintiffs’ settlement demands
  - Insureds’ demands to participate meaningfully/settle

Questions??

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