Meeting The Good Faith Obligation During Claims Handling

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Bad Faith: Historical Perspective

Breaches of insurance promises treated the same as breaches of ordinary commercial contracts

Policyholders wrongly denied of benefits received only the amount due under policy, plus interest

Substantive contract law prevented injured policyholders from recovering damages for emotional distress or economic loss caused by deprivation of policy benefits

Punitive damages unavailable in breach of contract action
Insurance Contract Differs from Ordinary Contract

Not obtained by policyholder for commercial advantage

To protect policyholder against unknown calamities

Policyholder often in vulnerable economic / personal position when loss occurs

Special relationship arises out of disparate bargaining power between insurer and policyholder

Potential exists for insurer to take advantage of policyholder at time when policyholder is vulnerable
Breach of Duty Recognized as Tort

- Initially recognized in third-party cases
- *Hiker v. Western Automobile Ins. Co.*, 231 N.W. 257 (Wis. 1930)

Plaintiff owned typical auto liability policy; policy provided defense / indemnity up to $5,000; Plaintiff sued after his auto struck a child; child’s rep offered to settle for less that policy limits but carrier refused; jury awarded $10,500 to child
Breach of Duty Recognized as Tort

- Initially recognized in third-party cases
- *Hiker v. Western Automobile Ins. Co.*, 231 N.W. 257 (Wis. 1930)

Court reasoned that expectations and vulnerability of policyholders in such situations mandated that policyholders’ rights “go deeper than the mere surface of the contract”
Breach of Duty
Recognized as Tort

- Initially recognized in third-party cases
- *Hiker v. Western Automobile Ins. Co.*, 231 N.W. 257 (Wis. 1930)

Court ruled insurers liable for actual damages for failure to consider interests of their policyholders when evaluating settlement offers
**Breach of Duty Recognized as Tort**

CA Supreme Court in *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973)

- Duty of good faith and fair dealing on the part of the insurance company is an absolute one
- Duty to insured exists in first and third party claims
- Insurer is liable in tort when it "unreasonably and in bad faith withholds payment of the claim to its insured"
- Advances social policy of safeguarding an insured in an inferior bargaining position who contracts for calamity protection, not commercial advantage
Non-Delegable Duty of Good Faith

Nondelegable Duty: Insurer cannot protect itself by transferring duty to third-party administrators and independent adjusters
Non-Delegable Duty of Good Faith

Laws of agency apply in insurer / TPA/IA relationship
Non-Delegable Duty of Good Faith

Laws of agency apply in insurer / TPA/IA relationship

- Conduct of TPA or IA is imputed to insurer
- Conduct of TPA or IA, even if wrongful and unknown, deemed to be conduct of insurer
- Insurer’s extra-contractual exposure is dependent upon reasonable conduct of its independent vendors
Non-Delegable Duty of Good Faith

Insurer may transfer risk with defense/indemnity agreement between insurer and TPA / IA
Duty of Good Faith and Fair Dealing

- Elements of cause of action for breach of duty of good faith and fair dealing under Texas law:
  - There was not a reasonable basis for denying the benefits
  - The carrier knew or should have known that there was not a reasonable basis for denying the claim or delaying payment of the claim
  - The delay proximately caused plaintiff’s damages
Duty of Good Faith and Fair Dealing

- Applies only to claims made by the insured (first party claims)
- No cause of action against the insurer by a third party asserting a claim against an insured (third party claim)
- Injured employee is an insured under workers’ comp policy to whom duty of good faith is owed
Actions Found to Violate Duty of Good Faith

- Failing to thoroughly investigate claim
- Exploiting the financial vulnerability of the policyholder
- Making unreasonable demands
- Spoliation of Evidence
- Refusing to compromise claims
- Making repeated low-ball settlement offers
- Forcing policyholders to litigate
- Failure to pay the full value of the claim
- Conditioning payment
- Retaliatory rescission or cancellation of the policy
- Retaliatory increase in premiums
Actions Found to Violate Duty of Good Faith

- Some Courts have found an affirmative duty to disclose benefits under a policy

- **Not in Texas**: *National Union Ins. v. Crocker* (Tex. Supreme Court 2008)
  
  - Employee was an additional insured under CGL policy;
  
  - Insurer had actual knowledge of the suit; but
  
  - Insurer had no duty to inform employee of the coverage or to voluntarily undertake employees defense
Actions Found Not to Violate Duty of Good Faith

- Insurer’s decision was based on bona fide coverage dispute
- Claim not covered by the policy
- Insurer’s decision based on objective and reliable information prepared by an expert
- Insurer’s decision based on an employee’s misrepresentation of his medical records when employer applied for coverage
Damages in Bad Faith Action

- Emotional Distress: Only when denial or delay of payment seriously disrupted the insured’s life.

- Economic Damages: i.e. loss of credit reputation or increased business cost

- Policy Benefits

- Punitive Damages: Only if damages were awarded for injury independent of policy benefits and the insurer’s conduct was malicious, fraudulent or grossly negligent
Statutory Bad Faith
Texas Insurance Code 541.060 “Unfair Settlement Practices”

- Failing within a reasonable time to:
  - Admit or deny coverage to a policy holder
  - Submit a reservation of rights letter
- Misrepresenting to a claimant a material fact or policy provision related to coverage at issue
- Failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim with respect to which the insurer’s liability has become reasonably clear
Texas Insurance Code 541.060
“Unfair Settlement Practices”

Failing to promptly provide to a policyholder a reasonable explanation of the basis in the policy, in relation to the facts or applicable law, for the insurer’s denial of a claim or offer of a compromise settlement of a claim.
Texas Insurance Code 541.060
“Unfair Settlement Practices”

Refusing, failing or unreasonably delaying a settlement offer on the basis that other coverage may be available or that third parties are responsible for the damages suffered, except as may be provided in the policy.
Texas Insurance Code 541.060
“Unfair Settlement Practices”

Undertaking to enforce a full and final release of a claim from a policyholder when only a partial payment has been made, unless the payment is a compromise settlement of a disputed or doubtful claim.
Texas Insurance Code 541.060 “Unfair Settlement Practices”

- Refusing to pay a claim without conducting a reasonable investigation
Texas Insurance Code 541.060
“Unfair Settlement Practices”

- Refusing to pay a claim without conducting a reasonable investigation
- Requiring a claimant as a condition of settling a claim to produce the claimant’s federal income tax returns unless:
  - Ordered by a court
  - The claim involves a fire loss
  - The claim involves lost profits or income
Section 541.060 does not provide a cause of action against the insurer to a third party asserting a claim against an insured (third party claim)
Texas Insurance Code
Section 541.152

A prevailing plaintiff may recover:

- Attorney’s fees
- Injunction
- On a finding that the defendant knowingly committed the act, an amount up to triple actual damages
Negligent Failure to Settle (Stowers Duty)
Negligently Failing to Settle (Stowers Duty)

Texas Law: Insurer must exercise that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business in responding to settlement demands within policy limits.

Elements:

- Claim against insured within scope of coverage
- There is a demand within policy limits
- The terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured’s exposure to an excess judgment
What About Stowers Demands for Multiple Claims?
Texas Farmers Ins. Co. vs. Soriano, 881 S.W.2d 312 (Tex. 1994)

In Soriano, the Texas Supreme Court held that when an insurer is faced with a settlement demand arising out of multiple claims and inadequate proceeds, an insurer may enter into a reasonable settlement with one of the several claimants even though such settlement exhausts or diminishes the proceeds available to satisfy other claims.

Key word is "reasonable"
What About Stowers
Demands for Multiple Claims?
Texas Farmers Ins. Co. vs. Soriano, 881 S.W.2d 312 (Tex. 1994)

Insurer could not be held liable unless:

1. Insurer negligently rejected a demand from the Claimant within policy limits; or
2. The settlement was itself unreasonable.

Additionally, the Court noted that simply because one claim may be more serious was not evidence that the other settlement was unreasonable.
What About Stowers Demands for Multiple Claims?
Texas Farmers Ins. Co. vs. Soriano, 881 S.W.2d 312 (Tex. 1994)

What the Texas Supreme Court has articulated in Soriano is that "unreasonableness" is not to be determined by comparing the value of competing claims. Instead, one must look to what a reasonable prudent insurer would do under the same or similar circumstances.
What About Stowers Demands for Multiple Claims?
Texas Farmers Ins. Co. vs. Soriano, 881 S.W.2d 312 (Tex. 1994)

Subsequent cases have indicated the "reasonableness" standard is tough to overcome whether faced with multiple claims, multiple claimants or both.
Performing the Adjustment Function
## Initial Meeting with Policyholder

<table>
<thead>
<tr>
<th>Explain what inspection, appraisal and investigation will be performed</th>
</tr>
</thead>
<tbody>
<tr>
<td>For property claims, inform policyholder what is required to protect property and present claim</td>
</tr>
<tr>
<td>Supply inventory, proof of loss, other applicable forms</td>
</tr>
<tr>
<td>Note coverage questions or policy limitations / exclusions</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Explain time frame involved to process &amp; conclude claim</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where applicable, assist policyholder in protecting property</td>
</tr>
<tr>
<td>Where applicable, make emergency payments</td>
</tr>
<tr>
<td>Where applicable, assist policyholder with temporary housing</td>
</tr>
</tbody>
</table>
Investigation of Claim

- Claims adjuster responsible for determining what investigation is appropriate
- Adjuster’s investigation should determine the facts about what caused the loss, how coverage applies and amount of loss
- Conduct investigation in timely manner
- Conduct unbiased investigation
  - Avoid using leading questions that might slant answers
  - Work with unbiased service providers
  - Seek to discover facts and consider ALL sides of the story
Evaluation of Claim

- Evaluate claim as if no limit of liability exists
- Conduct prompt evaluation
- When insured or plaintiff’s counsel provides evidence of claim, be receptive and careful in responding
- Do not act in arbitrary manner or abruptly supply comment
- Do not focus exclusively on denying the claim
- Do not utilize computerized evaluation programs in rigid manner; be flexible and realistic in assessing liability and damage potential
The Claim File

- Most crucial evidence in a bad faith claim
- Is a unique, contemporaneously prepared history of the company’s handling of a claim
- Provides best and only evidence of what happened during adjustment
- Documentation in each claim file demonstrates how insurers conduct claims investigation, evaluate claims and negotiate
- Activity logs, correspondence and documentary evidence are indicative of whether claim reps, supervisors and managers are doing their jobs properly
The Claim File

Fair dealing and good documentation are especially important in following instances:

- **Claim Denial**
  - Claim representative should have a thoroughly documented claim file before denying a claim

- **Errors**
  - If an error is discovered, fair dealing and good documentation will help explain error
Proactive Claims Handling

- Accurately record the analysis of the insured’s proof of loss
- Record all facts, damages and other information affecting coverage
- Where a decision has been made, include supporting documentation in the file
- Document responses to any correspondence, communication or allegations made by plaintiffs
- Make sure file is thorough and well organized, containing only information that pertains to the claim in question
What *NOT* to Include in Claim File

- Verbiage that provides appearance of unreasonableness
- Verbiage pertaining to racial, sexual or religious orientation
Fact or Fiction?

“Dear Mrs. Black,

On seven prior occasions this company has denied your claim in writing. We now deny it for the eighth and final time. You must be stupid, stupid, stupid.”
This One Is Fiction

From John Grisham’s *Rainmaker*
What *NOT* to Include in Claim File

**Incriminating statements:**

On memorandum from attorney urging settlement of multiple claims within policy limits, claims supervisor wrote: “I told him NO! To try the other cases as we are only gambling with $5000”
What NOT to Include in Claim File

Incriminating statements:

“The house is filthy and unsafe for habitation. I told the insured that before I would inspect the damage, she had to clean the place up and call an exterminator.”
What *NOT* to Include in Claim File

**Incriminating statements:**

“The insured became very upset with my explanation. I definitely do not want to cover this loss after the way she acted.”
What *NOT* to Include in Claim File

**Incriminating statements:**

“I denied coverage for the extensive damage to the floor as the cause of loss is unknown. The insured requested an expert identify the source of water. I told her that I am the expert and the damage is not covered.”
What *NOT* to Include in Claim File

**Incriminating statements:**

“My inspection of the roof indicated extensive damage. I do not know what caused the damage, so I won’t cover the loss.”
What *NOT* to Include in Claim File

*Incriminating statements:*

“After reviewing the insured’s inventory form, it is obvious she is lying. No one living in a house like hers could ever afford contents she is claiming. The insured stated she inherited most of her belongings from her mother who died last year. I don’t believe this. If the insured can’t produce receipts, I will deny claim.”
What *NOT* to Include in Claim File

**Incriminating statements:**

“The insured submitted notarized lighting affidavits for the damaged contents. I disagree and am therefore denying coverage for the loss.”
What *NOT* to Include in Claim File

**Incriminating statements:**

“The insured will not call me back while I am at the office. He keeps leaving messages on my voice mail after hours while I am not here. I will close the file until he calls me back while I am in the office.”
Claim File Should Not Reflect:

- Delay
- Indecision
- Inconsistency
- Pre-judgment
- Disparagement / mean-spiritedness
- Bias
Additional Considerations
Duty of Good Faith in Context of Litigation

Some courts have ruled quasi-fiduciary duty continues throughout litigation between policyholders and insurers.

Conduct that occurs after the onset of litigation between insurer and policyholder may be placed before juries in related “bad faith” tort actions.
Duty of Good Faith in Context of Litigation

White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985)

- Western’s settlement offers of $3000, $5000
- Western’s failure to provide written appraisal supporting the original offer
- Western’s unsuccessful MSJ
- Attorneys fees incurred in prosecuting suit
- Other conduct evidencing delay
Duty of Good Faith in Context of Litigation

White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985)

- Western contended the evidence of its post-filing conduct should have been excluded on the grounds that, once suit has been filed, the insurer stands in an adversary position to the insured and no longer owes a duty of good faith and fair dealing
Duty of Good Faith in Context of Litigation

White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985)

- Implied covenant exists in all insurance contracts
- Duty must be regarded as continuing after the onset of litigation, even with regard to the litigated claim
- Conduct inconsistent with this duty is evidence of bad faith
The Right to Be Wrong

- Insurance company has the right to be wrong
- Evidence that merely shows a bona fide dispute about the insurer’s liability on the contract does not rise to the level of bad faith
Top Five Ways to Get to Bad Faith

1. Bias
2. Disparagement
3. Inconsistency
4. Indecision
5. Delay
Closing Points

- Be reasonable
- Be Fair
- Be prompt
- Be Consistent
- Be Professional
- Remember that any notation in claim file is potentially discoverable and could become a future trial exhibit
- Avoid being Biased
  Unfair
  Mean