PROTECTING AGAINST FRIVOLOUS ALLEGATIONS OF BAD FAITH

Kent M. Bevan Dysart Taylor Cotter McMonigle & Montemore, PC

Frivolous bad faith allegations are always a concern for insurers. Plaintiffs and their lawyers have an obvious financial incentive to assert bad faith claims because of the possibility that they can recover a far greater amount than what policy limits provide. Unfortunately, the mere perception of bad faith can lead to problems for insurers, even in the absence of genuine bad faith.

Part of the problem is the "David vs. Goliath" mentality that sometimes motivates jurors to find in favor of whom they consider to be the "underdog." When they see a plaintiff, often a lone individual who has been hurt in some unfortunate event, take on an insurance company for denying the claim, their sympathies naturally lie with the plaintiff.

WHAT IS "BAD FAITH" AND WHY DOES IT MATTER?

There are conflicting opinions in various jurisdictions about what constitutes bad faith by insurers and what remedies may be available to policyholders. It isn't enough for insurers not to act in bad faith – they must also be able to demonstrate that they acted in good faith.

Some states prohibit bad faith generally whereas others have enacted laws that specifically define prohibited bad faith conduct. A growing number of states have sought to protect policyholders by creating statutory causes of action for bad faith, and some have created policyholder bills of rights. Even if there is no coverage, the manner in which a claim is handled can still result in a bad faith claim against an insurer.

Generally speaking, when an insurer fails to pay a claim without a reasonable basis for doing so, or fails to investigate the claim in a timely manner, a case can be made that they are acting in bad faith. Some of the ways that plaintiffs frame their arguments to show bad faith include:

- Deliberately deceptive or abusive practices to avoid paying claims;
- Not communicating with claimants in a timely manner;
- Unreasonable conduct in litigation involving a claim;
- Unreasonable or inappropriate demands;

- Either not following or not having company procedures to investigate claims;
- Not disclosing policy limits or policy provisions and exclusions;
- Attempting to enforce provisions that are inherently unenforceable; and
- Directly advising a claimant not to obtain the services of an attorney.

Here are some real-life examples of successful bad faith claims leading to damages against insurers:

- *A plaintiff sought representation through his homeowner's policy after he was sued in connection with a collision. Plaintiff claimed that the default judgment entered against him after defendant refused to defend him caused emotional distress. Jury returned a verdict of $300,000 for pain and suffering, over $500,000 for the default judgment and $25,000,000 in punitive damages for insurance bad faith.*

- *A jury returned a verdict of $400,000 for refusal to defend and indemnify in a series of lawsuits, including $386 million in punitive damages which the trial court later lowered to $71 million.*

- *A refusal to pay a $1,000 claim for burial expenses of a deceased child under a life insurance policy with no reasonable basis for denial resulted in a $750,000 punitive damage award for bad faith. This amount was affirmed on appeal. The court suggested that the fact the policy was so small was a reason to impose severe punitive damages because insureds would have a difficult time obtaining an attorney to take a case with such a small policy at issue.*

- *Plaintiff alleged that defendant misrepresented the policy deductible of her health insurance. Plaintiff claimed past medical expenses of $14,000, but defendant offered $6,000 prior to trial. The jury returned a verdict of $14,000 and $1,000,000 in punitive damages.*

- *A state supreme court found that an excess judgment is not required to maintain an action against an insurance company's bad faith refusal to settle. The insurer's duty is to protect the insured's financial interests and put its well-being above that of the insurance company. The court ruled that an insured's premiums pay, in part, for the insurance company's obligation to act in good faith when settling a third-party claim. An insurer can be held liable over and above its policy limits if it acts in bad faith in refusing to settle a claim against its insured within its policy limits when it has the chance to do so. Here, there were several opportunities for the insurance company to settle within policy limits, but the carrier waited until after the family in a wrongful death case was no longer willing to accept the policy limits offer. Therefore, the carrier's payment up to policy limits did not make its insured whole or put the insured in the same position it would have been in had the insurance company performed its obligations in good faith in a timely manner.*

BEST PRACTICES FOR AVOIDING BAD FAITH ALLEGATIONS AND HOW TO HANDLE THEM

First, make sure to fully investigate claims according to statutes and your internal policies. Investigations need to take place in a timely manner following the claim, and they need to be documented without editorial comments. If coverage will be denied, then that decision must be made in a timely manner as well. Keep date-stamped, detailed, and accurate records of all claim investigation activity, and preserve them because litigation can occur years after a claim is made.

The importance of good record-keeping cannot be overstated. You can assume that everything in the claims file will be discovered in litigation, which can either be detrimental or helpful depending on how well you keep and organize records. Another thing to keep in mind is that disparaging comments about insureds in the claim file such as "this person is such a liar" will only hurt you. They may even give rise to a claim of defamation.

When you do deny a claim, it is important to clearly state all the bases for which the claim is being denied. You should cite the specific language in the policy you're referencing as the reason the claim is being denied and do not paraphrase. If you do paraphrase the reason, then it could look like you are acting in bad faith when you are not. It is a good idea to have legal counsel review any denial letter before it is sent out.

If you deny a claim based on the medical opinion of a doctor you hired, the insured and his or her attorney will view the doctor as being in your "camp," as opposed to being independent. As a result, they may attempt to show that you and the doctor are in cahoots to conspire against them. This means that correspondence with doctors or other experts you hire should only concern the facts of the claim. You should keep doctors and any other experts you hire at arm's length in your correspondence about the claim.

Policy provisions and exclusions must be enforceable according to the law. The insurer is generally thought to be the one with knowledge of the laws that apply to their insurance policies. If coverage is denied because of a provision or exclusion that is not enforceable, this looks like bad faith in action. Genuine ignorance of the law won't be an effective defense.

The insured and their attorney will also be looking for opportunities to convey to judges and juries that you and your company are "bad" and deserve to be punished. As a result, plaintiff's lawyers will seek to discover information about your company that they can frame as being supporting of a culture of bad faith. This can include, but is not limited to, claims handling procedures, claims payment goals and incentives, quotas, and correspondence with insurance rating companies as well as training manuals for new employees, management conference materials, and operations reports.

Finally, pay attention to the insured's actions during the claims process that may show them to be uncooperative or in violation of their "duties" set out in the policy. These factors can play into your ultimate liability in a bad faith claim against you, and may even protect you from it completely. Did the insured obfuscate or misrepresent relevant information on their paperwork? Did they act in an abusive way or fail to cooperate during the claims process? Keep detailed records of this behavior in the claim file as well.

Unfortunately, there is no way for insurers to protect themselves completely from the specter of bad faith allegations. This means you should take every precaution to not only follow every rule and procedure, but to document every step you take as well – if it's not in writing in the file, it didn't happen. This way, if a bad faith allegation is made, it can't be supported by the evidence. Following these best practices should help protect you and mitigate the damage that can be done by an allegation of bad faith.

Kent M. Bevan is a director and shareholder at Dysart Taylor in Kansas City, Missouri. His practice focuses on insurance law and litigation. Kent regularly writes alerts with analyses of recent court decisions involving insurance litigation which you can view at http://dysarttaylor.com/news-events/alerts. You can view his expanded bio at http://dysarttaylor.com/our-people/kent-m-bevan or contact him at kbevan@dysarttaylor.com.