

BAD FAITH AS A CONTINUUM:
FROM CLAIM TO TRIAL

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I.

INTRODUCTION

The concept of bad faith can only be clearly understood if viewed as a continuum. This requires that the claims handler and defense counsel look forward and backward after receiving notice of a lawsuit. The claims handling field is fraught with dangers; if the claims professional does not understand the impact of action or inaction during the claims handling process, a bad faith claim may result. Similarly, potentially large verdicts can emerge if defense counsel does not fully understand the claims handling process. Specifically, the claims professional must look forward to assess how action or inaction will be viewed by a jury. Defense counsel must look backwards at the process, however, considering how to profile the claims professional before the jury. Counsel also must determine whether to adopt a proactive or reactive approach to the defense process.

This article is divided into three sections and highlights what the claims professional should know about the present bad faith environment, what defense counsel should consider when advising its client about the proper approach to defend a case, and what both should know about potential challenges at the time of trial. Each of these matters must be assessed separately, but should be viewed as interrelated. Absent that approach, bad faith litigation will continue to plague the industry.

II.

BAD FAITH AVOIDANCE: WHO SET THE TRAP?

A. The Dilemma

Education, not insensitivity, cynicism or skepticism, is the principal tool in avoiding bad faith. However, even the most educated claims professional can be blind-sided in the claims handling and litigation processes, absent a clear understanding of the bad faith “setup,” and an actual awareness of who set the trap. The focal issue can be framed in the alternative: (1) was the trap set by the insured and its counsel and/or the third-party claimant and its counsel, or (2) was it set by the claims handling professional at the adjuster level or at the management level of the insurance company? The purpose of this article is to help identify what prophylactic

measures should be taken to prevent setting the trap at the outset; to identify what proactive measures are needed after the trap has been set; to identify who set the trap, and to provide some practical and tactical recommendations to remove the bait from the trap before it is sprung.

Bad faith has been variously described by courts and commentators. It abides many definitions:

1. *irrational recalcitrance* on the part of the insurer to pay what is due to the insured;
2. *reprehensible conduct* designed to redirect small amounts from all property damage claims;
3. *evil mindedness* of the adjuster, which results in a refusal to pay a claim;
4. “*malicious intent*” of the adjuster in investigating the claim; and
5. “*conscious wrong doing*” and “*spite*” towards the insured.

These descriptive words have been used to characterize the insurer’s actions within the context of both first-party and third-party claims. It should be noted, however, that this article is not intended to provide a complete analysis of the legal standards applied within the first- and third-party context.^[1]

One of the dominant goals of the education process is to prevent the insurer from entering the “Bad Faith Insurer Hall of Shame,” promoting its entry instead into the “Good Faith Insurer Hall of Fame,” as published by Fight Bad Faith Insurance Companies (“FBIC”) (a non-profit advocacy organization) at www.badfaithinsurance.org. Although reading such publications can be highly inflammatory from the insurance industry perspective, these publications serve to identify the existing climate under which the claims professional and defense counsel must operate. Recognizing where the problems and potential exposure lie, and taking proactive steps to prevent the bad faith claim constitute more realistic goals for the insurance industry to pursue. These goals can be achieved by educating the industry about acceptable claims handling procedures and analyzing how the industry’s actions or inactions will impact the insureds and be judged by the courts.^[2]

B. *Who Set the Trap?*

1. The Right to be Wrong

While the claims professional should be ever vigilant to the bad faith setup or trap, the industry should also recognize that the insurance company does have the right to be wrong; an insurer is not compelled to pay a claim or settle a case just because a claim is made or a settlement demand issues from the claimant. Unfounded claims and exorbitant demands within the policy limits need not be paid and should not be paid.^[3] Regardless of the specific standard applied in either the first- or third-party context, most courts agree that a “reasonableness” or “fairly debatable standard” should be applied. Not only does an insurer have the right to be wrong, some

jurisdictions even recognize an insurer's duty to verify that the claimant (i.e., either a third party or its own insured) did not cause the loss so as not to pay suspicious or collusive claims. Such a duty protects the insurer's innocent premium-paying insureds. In *Time Insurance Co., Inc. v. Harvey Burger*,^[4] the Florida Supreme Court noted: "Insurers have a right and a duty to other policyholders to contest illegitimate claims. This statute should not be given a construction which destroys that right or frustrates that duty. Payment of illegitimate claims raises the cost of insurance for all policyholders."^[5]

The claims professional, who often consults with counsel when determining its position with respect to a particular claim, will sometimes aver that he or she relied on the *advice of counsel*. Courts traditionally have held that an insurer's failure to follow the advice of counsel is evidence of bad faith. More recently, the courts have held that reliance on the advice of counsel is but one factor in determining whether the insurer acted in bad faith, rather than an absolute defense to the claim.^[6] It should be noted, however, that reliance on the advice of counsel must be reasonable, resulting from something more than wishful thinking on the part of the claims professional.^[7] But what if the advice given by counsel is erroneous?

In *Gordon v. Nationwide Mutual Insurance Co.*,^[8] an insurer relied on counsel's advice that a policy could be validly canceled. The New York Court of Appeals responded that reliance on advice of counsel is an absolute defense, noting: "It would be an extraordinary result to hold a client guilty of breach of good faith, with large punitive damages, because it acts on advice of counsel -- even mistaken advice"^[9] In contrast, the Court of Appeals for the Fifth Circuit determined in *Blakely v. American Employers Insurance Co.*^[10] that the advice of counsel was irrelevant: "We do not hold to the view that an insurer can relieve itself of its duty to investigate, negotiate, settle or defend a claim by showing advices from its investigators, adjusters or legal counsel."^[11] There appears to be no consistency among the various jurisdictions; therefore, it is incumbent upon claims professionals and practitioners to review the law in the controlling jurisdiction.^[12]

2. Claims Professional's Conduct

Did the claims professional set his or her own trap within the context of the relevant action or inaction? Traditionally, in the claims adjustment process, the claims professional exercised nearly unfettered discretion in adjusting both the first-party and third-party claims. Within this context, bad faith claims focused on the actions or inactions of individual adjusters, asking whether those actions or inactions violated the bad faith standard as

applied in a given jurisdiction. Within the first-party context, claimants generally allege that the insurer committed bad faith because:

- a. it arbitrarily and capriciously denied a claim;
- b. it unscrupulously denied a claim, placing its own interests over those of the insured;
- c. it denied a claim that was reasonable or fairly debatable;
- d. it denied a claim where there was no bona fide dispute; or
- e. it denied a claim without adequate investigation.

In the third-party context, claimants generally allege that the insurer:

- a. failed to provide a defense for a third-party claim in good faith;
- b. failed to properly settle the claim of a third party within the policy limits; or
- c. failed to provide an adequate defense.

The gravamen of these allegations deals with the reasonable conduct of the insured or its counsel. Therefore, the conduct must be judged by the individual claims professional and his or her supervisor within the confines of the applicable bad faith standard. If claims professionals are not keenly aware of which claims adjustment activities and attitudes can be problematic, they are setting themselves up for a fall.

There are, however, certain claims handling *do's* and *don'ts* that can help keep the claims professional out of trouble or out of the trap. One of the clearest cautions prevents the claims professional from becoming a B.U.M.; that is:

- 1) *Biased*
- 2) *Unfair*
- 3) *Mean*

This acronym was developed by Lee Craig, a partner with the law firm of Butler, Burnette & Pappas in Tampa, Florida.^[13]

Evidence of a claims professional's attitude and demeanor typically derives from oral comments or admissions made by the claims professional to the claimant. Such evidence can be found in the claims file, whether stored in hard or electronic copy, which generally is discoverable in most jurisdictions.^[14]

Furthermore, any notation in the activity log is potentially discoverable and could make its appearance as a trial exhibit. The following are reported "lapses in judgment" as taken from the activity log notes of actual

files:

- “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.”
- “I met with the tenant at the insured location. I told the tenant that the damage was caused by surface water and therefore, not covered. The tenant will explain to insured.”
- “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.”
- “The insured is stupid and does not speak English very well. I mailed him a denial letter in hopes he can read better than he speaks.”
- “The insured submitted notarized lightning affidavits for the damaged contents. I disagree with her expert and am therefore denying coverage for the loss.”
- “The insured is submitting a claim for water damage in dining room. I remember this house from a claim last year. The dining room is in the front of the house. There is no source of water near the dining room, so this must be caused by surface water, which is not covered. No inspection needed. I will send insured surface water denial letter.”
- “Attempted to contact the insured. I do not speak Spanish. I will close file at this time until the insured can get a translator for me to communicate with.”
- “It appears the damage is caused by foundation movement. The insured has hired an engineer who concluded the foundation damage is caused by a plumbing leak in the bathroom. The bathroom is about 40 feet away from the worst damage. A leak in the bathroom could not be causing this damage. No coverage extended.”
- “The insured became very upset with my explanation. I definitely do not want to cover this loss after the way she acted.”
- “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 purchase receipts, I will deny claim.”

- “My inspection of the roof indicated extensive damage. I do not know what caused the damage, so I won’t cover this loss.”
- “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.”^[15]

These “lapses” can be utilized by plaintiff’s counsel to establish a traditional bad faith claim, where the claims handler has no lawful basis on which to preclude the claim, and a non-traditional case, where there is an intentional or reckless failure to investigate whether a lawful basis exists on which to refuse payment.^[16]

The attitude of the claims adjuster is important to the overall process because authorities have recognized that “[b]ad faith is a very contentious issue for both the policyholders and insurance companies. . . . Such claims elicit strong emotions from the parties and often intensify the adversarial nature of a law suit.”^[17] To the extent that the insurer’s representatives add fuel to the fire by way of adverse attitudes and lapses, they subject themselves to *emotional distress* damages. While there appears to be no consistency among the various jurisdictions regarding whether emotional distress damages will be allowed in bad faith litigation, a number of issues can be determinative. These include whether the claim at issue is a third-party or first-party claim; whether the distress is severe, or differences between tort and contract law. In California, for example, emotional distress damages are recoverable only where the insured or third party has suffered some financial loss.^[18]

Claims professionals should consider the following recommendations to defuse the bad-faith time bomb that potentially awaits the unwary claims professional. Each of the items mentioned in the checklists below should be assessed on a case-by-case basis, although no single recommendation presents a “cure” for bad faith litigation.

3. Checklist: First-Party Claims

With regard to first-party claims, the claims professional should observe the following recommendations:

- a. Accurately record the analysis of the insured’s proof of loss; do not editorialize any adverse or personal impressions.
- b. Conduct a site investigation as soon as possible and record all facts, damages, and other information that impacts coverage.
- c. Review all obligations of the insurer to the insured and comply.

- d. Obtain timely coverage analysis where coverage issues are presented and advise insured of denial in a timely manner.
- e. Pay any portion of the claim that may be owing.^[19]

4. Checklist: Third-Party Claims

With respect to third-party claims, the recommendations are similar.

a. *Failure to Settle*

1. Investigate all liability aspects of the underlying claim.
2. Promptly evaluate both the liability and damage aspects of the case.
3. Keep the insured informed as to the liability assessment and value of the case.
4. Keep the insured informed of all settlement negotiations, any excess exposure, and the right to contribute.

b. *Failure to Defend*

1. Advise the insured of the insurance company's coverage position, consistent with any obligation imposed by statute or case law (i.e., reservations of rights or denial of coverage).
2. Institute a declaratory judgment and attempt to resolve coverage issues in advance of the underlying liability claim.^[20]

Superimposed across each of the foregoing obligations is the recommendation that the claims professional communicate in a direct, diplomatic, and professional fashion, articulating its position in a manner that can be easily understood by the claimant, the insured, and their counsel.^[21] At least one court has observed that “[t]he portion of the claims file which explains how the company processed and considered Brown’s [the insured’s] claim and why it rejected the claim are certainly relevant to these issues.”^[22] In the matter of *Brown v. Superior Court*, that court further noted: “The claims file is a unique, contemporaneously prepared history of the company’s handling of the claim; in an action such as this the need for the information on the file is not only substantial, but overwhelming.”^[23] Other courts have indulged similar observations: “It seems evident to us that in a case of alleged bad faith refusal to settle, the circumstances and content of the various negotiations and communications between the involved individuals are clearly relevant”^[24]

In light of these comments and because the documentation regarding negotiations and communications will become exhibits in any subsequent litigation, the claims handler must be sensitive to the tenor and manner in which these are recorded. Such awareness can forestall any trap, but equally important, it will prevent the trap from being sprung during the litigation.^[25]

5. Insurer's Corporate Policy

As noted earlier, the action or inaction of the claims handler traditionally forms the basis of a bad faith assault. According to some, however, the focus has changed:

Plaintiffs are broadening their assault against insurer's corporate policies and procedures on two fronts: class action litigation and single or small multi-party plaintiff cases. What characterizes both forms of attack is that plaintiff all but ignores the adjuster's claim specific decision. The trial bar's assault is against the company at the management level because the issue in the case is the allegedly improper guidelines and procedures, promulgated by management, that have been consistently followed by its adjusters, which reap unfair profits from the insurer's policyholders. The adjuster is portrayed almost as an ignorant pawn of corporate management.^[26]

The comments of Attorney Arnold D'Angelo raise the specter of institutional bad faith. Succinctly defined, it occurs "[w]hen corporate structure or policies encourage bad faith claims handling."^[27] These comments were made eleven years after Leo Jordan, Associate General Counsel for State Farm Insurance, offered the following advice to members of the American Bar Association in 1979:

The most important advice I can leave you with, is that the time has come for the insurance industry to do its own laundry. If there are practices and procedures which are tinged with questionable motivation or proprieties, they must be eliminated. If changes are needed in the way we do business, let the industry and its well-trained lawyers lead the way in the reform. We cannot allow the trial bar and courts to establish our practices for us. We will be far better off to cleanse our own procedures and openly present them for public scrutiny. Justice Louis Brandeis said it well: Sunshine is the most powerful disinfectant.^[28]

Over the past several years, insurers have adopted new claims handling guidelines in certain circumstances to address many of the issues raised by the challenge that claims adjusters had failed to properly investigate or process claims. Beyond these, changes in claims-handling guidelines were often dictated by economic factors affecting the insurance industry. However, it must be recognized that such procedures, practices and policies cannot be enacted in a vacuum; they should only be enacted “when the procedures have been adopted after a due diligence review which concludes that the practice fulfills the insurers’ contractual obligations and is otherwise in conformance with state law.”^[29] It is evident, therefore, that the individual(s) charged with the drafting of claims–handling policies, practices and procedures must be educated to the manner by which courts interpret existing policy language; they must clearly understand the impact of current and proposed statutory law. Furthermore, the insurer should be vigilant about proposed legislation and the sentiment expressed by the various state legislatures. After considering the impact of these variables, the insurer can determine whether to redraft its practices, policies and procedures and, in the right case, whether to redraft policy language. If an insurer does not develop its claims-handling and billing guidelines in this fashion, it is setting its own trap.

Representatives at the management level should also be aware that they may be joined as individual defendants in any litigation. If not specifically joined, they may be noticed for deposition.^[30] In an institutional bad faith claim, the industry representative will be subject as well to an extensive request for production of documents.^[31]

The obvious purpose of such discovery is to establish a “pattern and practice” of activity at upper management levels in order to bolster the punitive damage aspects of the bad faith claim.^[32] In addition to using traditional discovery devices, counsel for bad faith plaintiffs have developed other proof of pattern and practice. In one case, an insured school district sent letters and questionnaires to other policyholders in order to determine whether its insurers had engaged in a pattern and practice of denying similar claims.^[33] Defense counsel undoubtedly will challenge such evidence on grounds that it is prejudicial, confusing, and a waste of judicial time. However, it might be best to address and avoid bad faith claims by engaging a more realistic assessment of an insurer’s patterns and practices outside of the litigation process.

With respect to pattern and practice claims, commentator Arnold D’Angelo suggests several solutions for avoiding institutional bad faith claims:

Suits are always being brought attacking insurance practices and, when successful, should form the basis of an internal dialogue within the insurance company. If the practice under attack is critical to an insurer's strategy, the insurer should determine whether the policyholder assault is meritorious. If so, the policy should be modified or sacrificed. On the other hand, if the practice is critical to the success of the business, the company may be able to preserve the practice by changing the policy language. By doing so, any policyholder's suit which is brought will only be able to attack the insurer's past practices, and liability will be thereby limited.^[34]

6. Claimant's Setup

It is generally recognized that an actual offer within the policy limits is prerequisite to a bad faith claim. However, there are situations where a settlement demand is made by the claimant's counsel in order to set a trap for the claims professional.^[35] Thus, the claims professional should be wary when:

- a. Settlement demand is patently unreasonable, yet within the policy limits.
- b. Settlement demand is made with the specific intent not to settle the case.
- c. Terms and conditions (i.e., length of time the demand remains open) are so unreasonable that they cannot be met.

This bad faith setup has been described as follows:

Creative plaintiffs' attorneys often seek to expand the insurer's policy limits by staging facts that would give rise to bad faith liability. Sometimes these attorneys play "dirty pool" in their attempts to set insurers up for bad faith claims, using such techniques as making policy limits offers with unreasonable time limits, making offers before there has been adequate time for investigation or discovery and backing out of settlement agreements under pretexts they blame on the insurer.^[36]

When confronted by such situations, the claims professional should document all negotiations and maintain a log of all critical dates, noting what transpired on each date (i.e., noting the date and who said what regarding settlement). This documentation will assist defense counsel in alleging and proving the "setup defense."^[37] A review of existing case law clearly indicates that when faced with such settlement demands, the claims professional should develop a time line of critical dates. As noted in *DeLaune v. Liberty Mutual*

Insurance Co., an offer to settle made less than two months after the accident and ten months before trial, which was open only for ten days, “made it virtually impossible to make an intelligent acceptance.”^[38] Not only should the claims professional be prepared to document these critical dates, he or she must also document what was being done from a claims-handling standpoint during this time frame. This documentation will establish that the settlement demand could not be reasonably and realistically assessed, and that the claims handler’s reaction was reasonable.

7. Other Warning Signs

The claims professional should be aware of other warning signs that identify potential claims handling problems and occur on a daily basis. The National Insurance Crime Bureau has developed and published indicators that alert the insurance industry to potentially fraudulent claims. It has also published methods for assessing these claims. These types of claims often lend themselves to bad faith allegations. The following checklist may prove helpful when assessing whether a first-party claim carries the potential for bad faith:

- a) Claim is a large one.
- b) Claim is excessive in relation to the type of harm suffered or evidence submitted to support the claim.
- c) Insured has made frequent claims against this and other policies.
- d) Insured has retained an attorney to deal with the insurer immediately after the loss.
- e) Additional limits were placed on the insured item before the loss.
- f) Insured had been refused coverage by other carriers and is keenly aware of the claims process.
- g) Insured exhibits a cavalier attitude towards the loss and merely wants to be paid.
- h) Insured’s financial condition changed immediately before the loss.
- i) Insured makes inconsistent statements and is uncooperative.
- j) With respect to a fire policy, insured has absented itself from the property prior to the loss.

While factors of this nature do not conclusively identify all suspicious/fraudulent claims or predict that a bad faith claim will develop, they should put the claims handler on notice that his or her best practices should be followed. Such practices will also provide a strategy (substantiated by documentation) by which to proactively challenge the setup.

When dealing with a third-party claim, the claims handler should be sensitive to the possibility of collusion between the insured and the injured party when settlement has been effectuated without involving the insurer. It has been noted that a settlement:

[B]ecomes collusive when the purpose is to injure the interests of an absent or nonparticipating party, such as an insurer or non-settling defendant. Among the indicators of bad faith and collusion are unreasonableness, misrepresentations, concealment, secretiveness, lack of serious negotiations on damages, attempts to affect the insurance coverage, profit to the insured, and attempts to harm the interest of the insurer. They have in common unfairness to the insurer, which is probably the bottom line in cases in which collusion is found.^[39]

When faced with such indicators, the claims professional should document critical elements without reacting negatively, which might jeopardize the defense of any subsequent bad faith claim.

C. Proactive Claims Handling

The threat of a potential bad faith claim does not mean that the claims professional cannot or should not do what is expected in the position. The following are claims-handling pointers, some of which may seem obvious. However, the failure to follow many of these often results in bad faith claims.

1. Keep in mind that the ultimate goal is to commit no act (nor fail to perform some act) that can be utilized by plaintiff's counsel as evidence of bad faith.
2. Be sensitive to the allegations made by the insured, the claimant or counsel in correspondence, and identify strategies.
3. Document responses to any correspondence, communication, or allegations made by plaintiffs. Do not ignore phone calls or written communications.
4. Treat the plaintiff and/or insured with the utmost courtesy, even if the insurer believes the insured is attempting fraud.
5. Be aware of all applicable claims-handling practices and procedures; document how these have been followed or explain why they have not.
6. When the insured or plaintiff's counsel presents evidence of the claim, be receptive and careful in responding. Follow all leads.

7. When evaluating liability and damages, and responding to the insured or plaintiff's counsel, do not act in an arbitrary manner or abruptly supply comment.
8. Follow all leads both for and against the plaintiff's or the insured's claim. Do not focus exclusively on denying the claim.
9. With respect to the claims file:
 - a. Avoid any verbiage that provides an appearance of unreasonableness.
 - b. Where a decision has been made, include supporting documentation in the file.
 - c. Make sure the file is thorough and well organized, containing only information that pertains to the claim in question.
 - d. Avoid verbiage pertaining to racial, sexual or religious orientation.
10. Conduct all investigations in a timely and reasonable fashion, documenting the reasons for any delay.
11. Make sure all communications and documentation evidence an open mind in assessing the claim.
12. Do not react adversely to the aggression, rudeness or adverse and negative comments made by the insured or plaintiff's counsel. Do not be lulled into making statements that can be utilized as admissions of bad faith.
13. Move the file through the claims process in a proactive and orderly fashion.
14. Seek advice from co-employees, supervisors, and counsel where necessary; do not handle the claims file in a vacuum.
15. Be aware of all applicable legal standards by which your activities will be judged.
16. Attend continuing legal education programs to remain abreast of current obligations and dangers.
17. Do not conduct a pretextual investigation.
18. Never be perceived as placing company interests above the insured's.
19. Retain experts who will provide an independent assessment of the claims.
20. Do not utilize computerized evaluation programs in a rigid manner; be flexible and realistic in assessing liability and damage potential.
21. Assume that all statements, documents, letters, e-mails, and claims files will be exhibits in any bad faith case and prepare accordingly.

22. Retain defense counsel who is familiar with the company's claims-handling process.
Consistency between good claims handling and defense strategies is important.
23. Keep the insured informed.

Observing the foregoing recommendations will educate claims handlers and provide evidence to counter unwarranted bad faith allegations or the contention that the claims handler is a B.U.M.

Education is awareness, information, and communication coupled with an attitude of reciprocity, e.g., "do unto others as you would like them to do unto you." The educated insurance representative will enable defense counsel to properly evaluate and successfully litigate bad faith cases. While the insurance company controls the claims and litigation process contractually through policy language, that ability should not create the perception that company interests predominate over those of the insured. At all levels of the process, the representatives of the insurance industry and defense counsel must be aware of the atmosphere surrounding litigation of bad faith claims. They must clearly understand judicial standards and legislative intent as well. Absent a clearly defined and proactive educational program, the trap will be set and sprung before the bad faith letter leaves the insured's hands. A properly educated claims staff can assist defense counsel in assessing the case and handling the claim.

III.

"PROACTIVE" OR "REACTIVE:"

WHAT MESSAGE SHOULD BE GIVEN TO INSURERS IN TODAY'S BAD FAITH CLIMATE?

A. *The Problem*

Without specific dictionary definition, *proactive* is the term that generally describes an affirmative approach to a situation. *Reactive* is defined as tending to be responsive to a situation.^[40]

In today's insurance climate,^[41] an insurer who faces either a troublesome first-party or third-party claim that holds potential for developing into a bad faith claim should immediately assess its options and determine whether to be *proactive* or *reactive*.^[42] It is generally recommended that the insurance industry develop an internal program that prescribes proper claims-handling and litigation techniques. However, a program to identify such claims early in the process is equally important. Similarly, once a bad faith claim is threatened, it is critically important to immediately define the defense strategy. This should include utilizing traditional breach of contract defenses and a creative approach to other defenses that may be available but untested in the particular jurisdiction. This section analyzes not only the traditional defenses available to insurers in a bad faith situation, but also assesses the current status of the comparative bad faith and reverse bad

faith defenses. It also discusses recent decisions where the insurer has confronted and successfully recovered damages from the insured (i.e., return of benefits paid, sanctions and fees, and costs). Finally, this section explores claims made by insurers against defense counsel.

Practitioners who litigate in the bad faith arena and claims professionals who are faced with potential bad faith or extra-contractual exposure must not be “gun shy.” While the potential for bad faith exposure can be significant and often affects the insurer’s public image through adverse publicity,^[43] the message of good faith must be projected to the public at large, as well as to judges and juries. Specifically, the duty of good faith and fair dealing implied in every insurance contract “is a two-way street, running from the insured to his insurer and vice-versa.”^[44] Recognizing that the implied covenant of good faith and fair dealing is a “two-way street,” one court noted that “the fact finder, in its search for the truth, should be able to look at the whole forest and not just a few of the trees. This should include a view of the insurer’s conduct as well as the insured’s.”^[45] Whether relying on traditional defenses or attempting to stem the tide that favors insureds by invoking the defenses of comparative bad faith and reverse bad faith, the practitioner and claims professional must be prepared to argue that the duty of good faith is a “two-way street.” If successful, the following headlines will attain a greater level of prominence:

- “Insured Who Inflated Loss Must Return \$1.5 Million to General Accident”^[46]
- “Jury Awards Allstate \$3 Million in Damages for Inflated Invoices”^[47]
- “Insurance Company Wins \$800,000 in Punitives Against Fraudulent Policyholder”^[48]

Furthermore, any *proactive* or *reactive* approach to an insured’s misconduct must underscore the concept that the insurance industry and the state insurance agencies are committed to eliminating insurance fraud. Such misconduct affects society as a whole; it undermines the insurer’s obligation to its other policyholders — to pay legitimate claims that should be paid and deny the false and fraudulent claims that should not. Only this approach will guarantee that the insurer can meet its obligations to all insureds.^[49] To that end, the analysis below identifies components of the basic dilemma.

B. *Insured versus Insurer, or Insurer versus Insured?*

1. Basic Elements of Bad Faith

For many reasons, the elements of bad faith are extremely difficult to assess. This difficulty is due perhaps to the changing nature of the claims, the inability of courts to agree on the standard of conduct to be used as a benchmark, the fact that some jurisdictions provide a statutory cause of action, or whether the cause of action is viewed as tort or contract within the jurisdiction. While a complete survey of the various states is beyond the scope of this article, each jurisdiction recognizes that a claim of bad faith emanates from the relationship between an insurance company (insurer) and its policyholder (insured).^[50] Based on that relationship, the courts recognize that an implied covenant of good faith and fair dealing exists in every insurance contract. A bad faith cause of action generally arises when an insurer fails to provide an insured with a recognized right provided by the policy and the insurer's failure violates the standard of conduct imposed by case law or statute. The standard of conduct differs from jurisdiction to jurisdiction. For example, an unreasonable standard or wrongful denial standard is used in California.^[51] However, a gross disregard or egregious conduct standard is used in New York.^[52] Other jurisdictions, such as Arizona, require an intentional denial without a reasonable basis.^[53] These differences illustrate the difficulty in assessing the particular elements of a bad faith claim and the need for the claims professional and practitioner to become familiar with the standard applied in the particular jurisdiction.^[54] Once the standard is determined, the strategy for defense of the case can be designed and implemented based upon that standard.

2. Contract versus Tort

Critical to any analysis of bad faith litigation is the question whether a particular jurisdiction bases the cause of action on breach of contract or tort theory. The particular theory adopted by the courts of a given jurisdiction can impact the nature and extent of damages, the length of the statute of limitations, and the types of defenses available. A majority of jurisdictions that have considered this issue have determined that the cause of action for breach by the insurer of the implied covenant of good faith and fair dealing sounds in tort.^[55] In *Kransco v. American Empire Surplus Lines Insurance Co.*,^[56] the California Supreme Court considered the matter but issued a decision that involved a majority opinion, a concurring opinion by one judge, a concurring and dissenting opinion by one judge, and a dissenting opinion by another judge. The majority opinion noted the following:

Because the covenant is a contract term, in most cases compensation for its breach is limited to contract rather than tort remedies. But “an exception to this general rule has developed in the context of insurance contracts where, for a variety of policy reasons, courts have held that [an insurer’s] breach of the implied covenant will provide the basis for an action in tort.” The availability of tort remedies in the limited context of an *insurer’s* breach of the covenant advances the social policy of safeguarding an insured in an inferior bargaining position who contracts for calamity protection, not commercial advantage.^[57]

The two dissenting judges also agreed that an action by an insured for an insurer’s breach of the implied covenant sounds in tort.^[58] As noted below, the *Kransco* decision went beyond this issue to consider an insurer’s bad faith claim against an insured.

As a result of the determination that the insured’s right to sue the insurer sounds in tort, the insurer who breaches an implied duty of good faith and fair dealing is liable for extra-contractual damages (i.e., the full amount of any judgment against the insured in excess of its policy limits).^[59] The rationale for extra-contractual damages has been described as follows: “The policy limits restrict the amount the insurer may have to pay in the performance of the contract, not the damages that are recoverable for its breach.”^[60] The insurer’s liability in the third-party context is triggered when there is an excess verdict in the underlying action.^[61]

Within the first-party context, a majority of courts have similarly determined that because an insured’s cause of action against an insurer sounds in tort, the insured is entitled to tort damages. These can include punitive damages as well, provided the insurer’s action or inaction warrants the imposition of extra-contractual damages.^[62] In this regard, courts have utilized the following standards to justify the imposition of punitive damages:

- insurer’s conduct was intentional or made without a reasonable basis;
- insurer’s conduct is egregious in nature; or
- insurer’s actions were wanton and willful.^[63]

The insured must allege and prove that the insurer’s conduct met one of these standards and that the insurer knew or should have known that it was acting unreasonably.^[64]

3. Insurer Defenses and Causes of Actions

When faced with first- or third-party complaints that allege bad faith in violation of the applicable standard, seeking to establish extra-contractual damages, the practitioner representing the insurer must immediately assess all available defenses and potential affirmative claims. Many of the defenses are fact-driven. Thus, the ultimate goal should seek to review all action or inaction of both the insurer and the insured in order to strategize dismissal of the complaint or reduction in compensatory (contract) and extra-contractual (tort) damages. To this end, it is important to investigate any defenses available in the particular jurisdiction whose laws will control the litigation. Before discussing any available contractual defenses, the defenses of comparative bad faith and reverse bad faith should be considered in light of recent case law and other commentary.

a. *Comparative Bad Faith*

Simply stated, comparative bad faith is an affirmative defense based upon the standards of comparative fault; it is designed to apportion damages between the insurer's and the insured's bad faith conduct.^[65] However, this defense was rejected recently by the California Supreme Court in *Kransco*, despite earlier legal speculation that "California courts would reduce punitive damages awards when the insurer submits a proper special issue calling for an allocation of the percentages of fault based on the insured's and the insurer's malicious, oppressive or fraudulent behavior."^[66] Prior to the *Kransco* decision, many legal commentators had endorsed this affirmative defense.^[67] These discussions are still instructive in those jurisdictions which have not yet addressed the issue. Thus, practitioners who represent insurers should be familiar with the arguments supporting this defense.

When rejecting comparative bad faith, the *Kransco* majority left no room for doubt that such a defense is not viable within the third-party context:

We agree with the Court of Appeals below that the jury should not have been instructed at all within principles of comparative bad faith. . . . We observe that rejection of comparative bad faith in this context does not leave the insurer without remedies for an insured's breach of the covenant of good faith and fair dealing.^[68]

As noted, however, the court clarified that its determination would not diminish the insurer's ability to defend these bad faith cases, specifically noting that the insurer's remedy would lie with the following contract defenses:

[69]

- Insured's conduct may be used to disprove allegations that the insurer's conduct meets the applicable bad faith standard. [70]
- A breach of the cooperation clause of the policy may result in a dismissal of the complaint. [71]
- A material misrepresentation by the insured voids coverage altogether. [72]
- Fraudulent misconduct provides a separate, distinct defense and is separately actionable. [73]

Each of these defenses is separate and distinct, requiring a specific factual analysis unique to the particular defense.

The *Kransco* case is not the only recent decision to consider accepting or rejecting the defense of comparative bad faith. The United States District Court for the Virgin Islands, Division of St. Croix, recently considered the application of this defense as well. In the matter of *In re Tutu Water Wells Contamination Litigation*, [74] that Virgin Islands district court made a similar determination:

Although there is existing case law which supports the adoption of comparative bad faith, the clear weight of authority holds to the contrary. . . . Thus the Court concludes, consistent with the mandates of Virgin Islands Code, that the common law as understood throughout the United States does not recognize the affirmative defense of comparative bad faith. [75]

In reaching its decision, the court refused to align itself with those jurisdictions that allow the defense. [76]

The Virgin Islands district court also declined to follow *Eastman Kodak Co. v. Traveler's Indemnity Co.* [77] In that case, the Superior Court of New Jersey allowed the defendant insurers to amend their answers and counterclaims to include common law fraud and a breach of the duty of good faith and fair dealing by the insured (a violation of the New Jersey Insurance Fraud Protection Act). The basis for the claims in the *Eastman* case was the insured's failure to provide critical information to the insurer regarding its coverage position. [78]

There is little doubt that *Kransco* will have significant impact on the defense of comparative bad faith. As one commentator speculated prior to the decision,

[t]he decision that will be issued by the California Supreme Court in *Kransco* is likely to have a great deal of influence on courts across the country with respect to their willingness to accept comparative bad faith defenses by insurance carriers. It may also affect the New York courts, which have not yet addressed the comparative bad faith doctrine.^[79]

Another commentator also surmised that recognition of the defense was the next logical step: “[T]he mere fact that Texas has consistently followed California in the area of insurance bad faith law supports adoption of the defense.”^[80] However, his surmised predated *Kransco*.

It should be noted that the *Kransco* decision is not without criticism. Notwithstanding *Kransco*, some case law and legal commentaries continue to support the defense:

Ultimately, some will explain *Kransco* as a case of bad facts making bad law, at least for insurers. . . . Unfortunately, rather than affirm the Court of Appeal’s decision on the facts of the case, the majority eliminated the defense of “comparative bad faith” as a matter of law.^[81]

In fact, one court has even suggested that bad faith law would be improved by a comparative bad faith defense.^[82]

The concurring opinion authored by Judge George in *Kransco* argued that the majority should not have rejected the comparative fault doctrine, noting that “the court should rest its decision in this case solely upon the narrower, and fully dispositive ground that the insured’s conduct here at issue negligently providing an incorrect answer to a discovery request does not constitute the type of misconduct that properly may reduce an insured’s liability or damage resulting from its failure to accept a reasonable settlement.”^[83] Notwithstanding his rationale, a majority of the court overturned the state’s prior law, which had determined that an insurer could raise as a defense the tort concept of comparative fault (i.e., comparative bad faith) in a bad faith action.

While the concurring and minority opinions indicate the fallacy of entirely rejecting the comparative bad faith defense, the majority appears to have reasoned from a faulty premise. Specifically, the majority rejected the principle that the obligations of insurer and insured are comparable and mutual in the insurance relationship. To

the contrary, the court observed that “[a] fundamental *disparity* exists between the insured, which performs its basic duty paying the policy premium at the outset, and the insurer, which, depending on a number of factors, may or may not have to perform its basic duties of defense and indemnification under the policy.”^[84] The court went on to conclude that since the insurer and the insured held different financial interests, “[a]n insured is . . . not on equal footing with its insurer — the relationship between the insured and insurer is inherently unequal, the inequality resting on contractual asymmetry.”^[85] Historically, of course, various commentators have noted that well-established public policy considerations are contradicted by the comparative bad faith concept. Specifically, one commentator has observed:

A major public policy consideration in insurance litigation is the concept of fairness between the insurer and insured “that is equalization of the contenders’ strategic advantages.” The superior advantage an insurance carrier has over its individual insured in all aspects of the insurer–insured relationship is most prevalent when it comes time for the insurers to “pay up” under the contract.

Due to their advantageous position over the insureds, this idea of fairness and equalization impliedly leads the courts to treat insurance policies as adhesion contracts.^[86]

Although the implied duty of good faith and fair dealing traditionally protected against this superior bargaining position,^[87] several commentators have questioned whether this “superiority” continues within the current climate, or whether insureds have increased their bargaining positions.^[88] In fact, it has been suggested that one size does not fit all and that all insureds are not created equal — at least with respect to commercial insureds.^[89] These insureds have greater sophistication, often have self-retained limits, employ risk managers, and have access to legal counsel and other professional advisors. Following this analysis, some have noted:

The implied duty of good faith and fair dealing originally served to protect against the unequal bargaining power held by the insured. Many insureds now enjoy greater bargaining power. The large disparity in bargaining power is a thing of the past. This has led to the development of comparative bad faith as an affirmative defense to offset the damages caused by an insured’s own bad faith conduct.^[90]

Other justifications by which to apply the comparative bad faith defense have surfaced as well:^[91]

- The defense of comparative bad faith is connected with the comparative responsibility system enacted in the jurisdictions.^[92]
- The defense is compatible with contractual liability theories within the jurisdiction.^[93]
- The concept of fundamental fairness is promoted by the defense by shifting the responsibility back to the insureds for their misconduct.^[94]

The defense of comparative bad faith clearly suffered a blow from the California precedent. At least in that state, the defense of a bad faith claim can be an all or nothing proposition. In defending both third- and first-party claims, a California insurer can avoid bad faith in two ways. By pleading and proving that the insurer acted appropriately under the circumstances without violating the good-faith standard, the insurer's counsel can utilize the insured's conduct to establish the overriding atmosphere and demonstrate how the insured's actions or inactions affected the insurer's ability to act. In the alternative, if the insured's conduct amounts to a breach of contract, misrepresentation, fraud, the failure to mitigate damages or the failure to cooperate, these defenses should be raised separately.

In other jurisdictions that either allow a comparative bad faith defense or have not yet ruled on the issue, the practitioner should plead the defense with specificity. These pleadings should aver generally that the defense of comparative bad faith is sought and request a reduction in the damages assessed, if any, in the insured's underlying bad faith claim against the insurer. Similarly, the practitioner in these jurisdictions should allege any applicable contract defenses. In addition, the practitioner should be aware that if the defense is not raised affirmatively in the answer, it can be waived.^[95]

b. *Reverse Bad Faith*

The issue presented by this defense is whether an insurer has the affirmative right to proactively sue an insured for breach of the good faith covenant of fair dealing. As one commentator has observed, "If the duty of good faith and fair dealing truly is a 'two-way street,' the answer to the question should be yes."^[96] One court has held that the doctrine of reverse bad faith "creates an independent tort that allows an insurer to seek affirmative relief for an insured's breach of good faith and fair dealing."^[97] If recognized as a tort, it appears

that extra-contractual damages would be allowed, whereas only compensatory damages would lie if the court recognizes that the cause of action is viable only in contract.^[98]

While many courts and commentators interchange the concepts of comparative bad faith and reverse bad faith, they are distinct.^[99] Comparative bad faith, as noted above, allows the court to apportion damages and reduce the bad faith compensatory and punitive damages awarded against the insurer in an appropriate case. Reverse bad faith involves an affirmative action against the insured, either as a direct cause of action in a complaint or a counterclaim, allows an affirmative dollar recovery in favor of the insurer against the insured,^[100] and places the action or inaction of the insured before the judge or jury.

The elements of a reverse bad faith claim have been identified as follows:

- The insured owes the insurer a duty to meet a specific standard of conduct with respect to the claim-handling and litigation process (i.e., duty of good faith and fair dealing);
- The insured breached that duty, and that breach interfered with the claim-handling and litigation process; and
- The insurer's ability to adjust or defend the case was affected, causing damage or prejudice to the insurer.^[101]

Given these elements, the practitioner representing the insurer should peruse the claims-handling and litigation processes to determine whether the insured's conduct during the "adjustment, investigation, negotiation phases of the first-party or third-party claims"^[102] violated the covenant of good faith and fair dealing.

Whether a reverse bad faith claim constitutes a viable alternative to insurers is still an open question in many jurisdictions. The availability of reverse bad faith was recently considered in the case of *In re Tutu Water Wells Contamination Litigation*.^[103] The court there reviewed existing common law throughout the United States. At issue in *Tutu Water Wells* was the insurer's contention that "its investigatory efforts, coupled with the plaintiff's [insured's] failure to provide the insurer with the relevant policy terms and conditions prior to Cigna's denial of coverage"^[104] constituted reverse bad faith. In order to determine the law of the Virgin Islands, absent guidance from the Restatement of Torts, the district court examined the common law throughout the United States. The court concluded its analysis as follows: "Since an examination of the current state of the law reveals

that ‘reverse bad faith’ has not been recognized by any jurisdiction in the United States, the Court must dismiss Cigna’s counterclaim for reverse bad faith.”^[105] The court specifically had reviewed the following authority:

- *Tokles & Son, Inc. v. Midwestern Indemnity Co.*,^[106] where the court rejected the defense, recognizing that an insurer has other avenues by which to pursue an insured for a fraudulent claim, and noting that the insurer holds the purse strings.
- *First Bank of Turley v. Fidelity & Deposit Insurance Co.*,^[107] where the court refused to acknowledge that an insured’s nonperformance of a contractual duty amounted to a free-standing breach of contract or a tort.
- *Johnson v. Farm Bureau Mutual Insurance Co.*,^[108] where the insurer claimed that the insured failed to closely examine the policy before alleging bad faith, and that this constituted reverse bad faith; the court rejected the defense since there were other remedies available.

To be candid, the court’s analysis appears to be incomplete; however, under the laws of the Virgin Islands, it was required to search for existing common law. The insurer had argued that “the refusal to recognize reverse bad faith would permit tortious conduct to result in damages for which the victim of the tortious conduct — the insurer — has no other remedy,”^[109] and the court recognized that this was a good argument. However, because the insurer did not cite a single jurisdiction that recognized reverse bad faith, the court declined to recognize the defense. The court thus felt compelled to ignore the insurer’s good argument, but it conducted no independent analysis of case law indicating that a reverse bad faith defense could exist.^[110] Thus, it ignored the following significant implications:

- *First Bank of Turley v. Fidelity & Deposit Insurance Co.*,^[111] where the court considered the nonfeasance of the insured, but did not rule that a reverse bad faith action should be precluded where malfeasance existed.
- *Parker v. D’Avolio*,^[112] where the court noted that “indeed, case law suggests, in the context of insurance claims, that courts be vigilant to ensure that plaintiffs not engage in ‘reverse bad faith’ conduct.”^[113]

- *Snap-on Tools Corp. v. First State Insurance Co.*,^[114] where the court refused to consider a reverse bad faith cause of action on procedural grounds, but affirmed an award of compensatory and punitive damages against an insured.
- *Garvey v. National Grange Mutual Insurance Co.*,^[115] where the court allowed the bad faith claim against the insured to go to the jury based upon the insured's misconduct.
- *Gendreau v. Foremost Insurance Co.*,^[116] where the court found that the insured knew the claim was false and, based upon a jury finding that the insured acted in violation of a state statute, affirmed the award to the insurer against the insured.

In addition, Tennessee statutorily provides a remedy against an insured and in favor of an insurer, which becomes part of the insurer's action.^[117]

In its search of the applicable common law, the district court in *Tutu Water Wells* also ignored various unreported decisions which offer compelling reason to recognize a cause of action for reverse bad faith.^[118] Further, because the decision was premised on established common law, the court could not resort to the opinions or rationale of those commentators who favor the adoption of reverse bad faith.^[119] This factor alone should reduce the precedential value of the case.

Those courts which have rejected the application of reverse bad faith have relied on such reasons as the disparity of the bargaining power between the insurer and insured, the fact that it is the insurer who drafts the contract of insurance, the claim that the insured will not have the same incentive to sue the insurer for bad faith, and the fact that the insurer has other remedies available to redress any wrong. These reasons are not without challenge, however. As noted above, the disparity in bargaining position and financial ability is now subject to question in light of the existing insurance climate. Further, as noted by one commentator, "bad faith has nothing to do with business acumen and financial recourse; it has everything to do with malice and wrongful conduct."^[120] Also, while judicial perception regarding the disparity "may be true with respect to individual insureds or small businesses, it is not universally applicable. Commercial insureds with substantial assets and ready access to legal advice are on relatively equal footing with their insurers. Such equality of bargaining power and sophistication removes the need for preferential judicial treatment."^[121]

It has also been argued generally that a cause of action in reverse bad faith within the first-party context (i.e., arson or fraud) should be allowed. One commentator has listed ten arguments favoring such a cause of action:^[122]

- An insured suffers alleged financial straits because of its own actions (arson or fraud).
- The claim for fraud and/or arson are “factually and legally irrelevant and immaterial to the essence of relative bargaining strengths.”^[123]
- Exclusions for wrongful acts are meant to prevent an insured from profiting from its own acts.
- A reverse bad faith claim, because it is based on good faith action, is implied in law; it should not be precluded because the insurance contract is perceived to be an adhesion contract.
- Other available remedies do not allow an insurer the opportunity to seek affirmative relief for compensatory and extra-contractual damages.
- An insurer should not be precluded from asserting a compulsory counterclaim remedy because it engages in the business of insurance.
- An insurer should be allowed to pursue its claim within the context of the same action and should not be prevented from doing so in the interest of judicial economy.
- Other remedies such as sanctions are generally assessed against counsel and rarely sufficient to cover all damages.
- The availability of a reverse bad faith cause of action will check unjustified and baseless bad faith claims by an insured.
- Mindful of the economic bottom line, insurers will not institute frivolous or malicious claims.

Because courts have tended to favor insureds over insurers and have not often assessed the internal operations of the insurance industry, it should be argued that “judicial consistence”^[124] favors the recognition of reverse bad faith. A practitioner who represents the insurance industry should, in the right case, utilize the foregoing arguments to inform the court that the traditional reasons for disallowing a reverse bad faith cause of action are no longer viable.

c. Abuse of Process/Sanctions

In today’s insurance climate, the number of bad faith claims attached to first-party contract claims has increased significantly. From a practical standpoint, counsel for the insured attempts to gain some leverage in the bargaining and settlement process by routinely attaching a bad faith claim to a claim that is purely contractual

in nature. In recent years defendants have clamored for recognition of a “new tort,” i.e., malicious prosecution. However, plaintiffs continue to debate the need for such a cause of action.^[125]

Historically, courts have been reluctant to find abuse of process.^[126] The decision in *Johnson v. Farm Bureau Mutual Insurance Co.*^[127] helps to clarify the limitations of this defense within the context of bad faith litigation. In that case the insurer alleged that the insured had abused the litigation process by filing a frivolous bad faith claim. Reasoning that such a claim would not lie under the circumstances, the court first defined abuse of process as “the use of legal process, whether criminal or civil, against another primarily to accomplish a purpose for which it was not designed.”^[128] Further, the court recognized two essential elements for such a claim: (1) use of the legal process; (2) in an improper and unauthorized manner.^[129] At first blush, it appeared that the insurer’s claim might fall within this definition; however, the court went on to note that the second element posed some difficulty because it required an “impermissible purpose or illegal motive.”^[130] Since settlement leverage was germane to the litigation process, the court rejected the insurer’s abuse of process claims: “Farm Bureau’s assertion that the bad faith claim was added to gain leverage for a settlement in the breach of contract claim does not advance its claim for abuse of process. Settlement is included in the goals of proper process, even though the suit is frivolous.”^[131] Consequently, the Iowa standard has been difficult to meet.

In other jurisdictions, the standards have proved equally difficult. For example, in the state of Florida, the tort of malicious prosecution requires an element of malice.^[132] Consequently, these standards may be insurmountable within the context of insurance litigation. However, the standard suggested by the court in *Aranson v. Schroeder*^[133] may be more plausible in this context. The court in *Aranson* determined that there is a viable defense to litigation initiated, continued or procured “primarily for a purpose other than that of securing the proper adjudication of the claim and defense thereto, such as to harass, annoy or injure, or to cause unnecessary delay or needless increase in the cost of litigation.”^[134] The case of *Old Republic Insurance Co. v. FSR Brokerage*^[135] likewise offers a more lenient standard:

[W]e discern in malicious prosecution a better procedure for resolving whether Old Republic’s fraud claim was meritless and improperly motivated than that adopted here to resolve FSR’s bad

faith claim. To establish a cause of action for malicious prosecution, a plaintiff must demonstrate . . . that the underlying action “was brought without probable cause.”^[136]

Although such standards ease the insurer’s burden, they do not imply that abuse of process occupies a viable niche in modern insurance litigation.^[137] That issue typically asks whether other mechanisms are available to deter frivolous bad faith claims. For example, the court in *Johnson* noted that: “[a] motion for rule 80(a) sanctions . . . does not require a wrongful motive to remedy the filing of a frivolous claim. We believe sanctions under Iowa Rule of Civil Procedure 80(a) provide an adequate remedy to insurance companies when an insured files a frivolous bad faith claim.”^[138]

Many jurisdictions award sanctions in one form or another against an attorney or party who prosecutes frivolous litigation.^[139] However, it is generally considered that very few courts award sanctions for the full amount of a party’s damages; therefore, the insurer requires other, alternate remedies in order to be made whole.^[140] Of course, the practitioner need not rely on state statutes or common law; the practitioner representing the insurer may wish to seek removal of the case to federal court in order to avail itself of the larger federal sanctions. In that regard, Rule 11 of the Federal Rules of Civil Procedure and 28 U.S.C. § 1927 are typically invoked.

Rule 11 provides in part that sanctions can be imposed against the party and/or the attorney for filing papers and arguing baseless positions. Further, § 1927 imposes sanctions when there is bad faith. Recently, in *Syracuse Exploration Co. v. Northbrook Property & Casualty Insurance Co.*,^[141] the district court issued sanctions against the insured’s attorney for making an unreasonable motion for a new trial following the defense verdict in a bad faith claim.^[142] These included attorney’s fees and costs. Chief Magistrate Judge Linnea R. Johnson also recommended reasonable attorney’s fees in the sum of \$579,644.30 and taxable costs of \$46,564.50 in *Dictiomatic, Inc. v. United States Fidelity & Guaranty Co.*^[143] These remedies effectively inhibit frivolous bad faith claims.

C. Insurer versus Defense Counsel

Most legal analysts recognize that “[t]en to 15 years ago malpractice suits by insurance carriers against their retained counsel were virtually unheard of, but today these suits appear to be on the rise.”^[144] Two recent cases conceptualize the relevant issues when an insurer seeks to recover its damages from defense counsel. In

Paradigm Insurance Co. v. The Langerman Law Offices,^[145] the Arizona Court of Appeals considered a malpractice counterclaim brought by the insurer against its retained counsel who had defended a physician insured in a medical malpractice case. The claim was based on allegedly incorrect advice given by counsel to the insurer regarding coverage issues. Initially, the Arizona court decided whether the insurer had standing to sue the defense counsel (i.e., whether an attorney–client relationship existed between the insurer and defense counsel). Having grappled with this issue for years,^[146] that court recognized that such a relationship exists absent a conflict of interest between the insurer and insured. Therefore, the insurer could institute an action against defense counsel. Specifically, the court noted: “[b]ecause there is no evidence of any conflict between Paradigm and its insured, a dual attorney-client relationship existed, and Paradigm is entitled to bring a malpractice action against Langerman. The trial court therefore erred in finding that Paradigm could not maintain a malpractice action against Langerman.”^[147]

The issue was similarly treated in *Gulf Insurance Co. v. Berger, Kahn, Shafton*,^[148] a malpractice action commenced against defense counsel who were hired by the insured from the insurer’s approved counsel list. (It should be noted that this was not a *CUMIS* situation). In deciding that an attorney–client relationship existed sufficient to provide the insurer with standing to institute an action against defense counsel, the court recognized a tripartite relationship under the circumstances. Citing *Bogard v. Employers Casualty Co.*,^[149] the court noted that “[t]he attorney hired by the insurance company to defend in an action against the insured owes fiduciary duties to two clients: the insurer and the insured.”^[150] However, not all jurisdictions recognize the insurer’s right to institute a direct action against defense counsel.^[151] For example, in *Safeway Managing General Agency v. Clark & Gamble*,^[152] the Texas Court of Appeals held that the insurance company must establish an appropriate relationship before a direct action can be instituted. However, in light of the decision by the Texas Supreme Court in *State Farm Mutual Automobile Insurance Co. v. Traver*,^[153] which adopted the one–client rule (insured) and specifically held that no attorney–client relationship exists between the insurer and defense counsel, a direct action is not permitted in the state of Texas.

If the jurisdiction does not recognize a two–client rule (insured and insurer), an insurer seeking to recover its damages against defense counsel should contemplate testing the following legal theories:^[154]

- *Equitable subrogation*—allows the injured or damaged party to stand in the place of the client and institute an action against the client’s counsel. This remedy is only available to excess insurers, but in

some jurisdictions the primary insurer holds the same right.^[155]

- *Assignment by insured to insurer*— in such situations an insured assigns its cause of action against defense counsel to the primary insurer or excess insurer. Upon consideration, however, most courts have rejected this issue on public policy grounds.^[156]
- *Third-party beneficiary*—under this theory the insurer contends that it is the third-party beneficiary of the relationship established between the insured and defense counsel. This theory, too, has been generally rejected.^[157]

A review of the relevant cases covering the impact of the insurer's right to sue defense counsel clearly indicates that the law is in flux. Unfortunately, the impact of these decisions holds significant ramification for the tripartite relationship since it affects the duty to defend and the use of case management and liability guidelines. Both the insurer and defense counsel should tread lightly in this area — especially where the law will be decided within the malpractice context. The best defense against these types of actions is still good lawyering, and the insurer must select qualified and effective defense counsel.

D. *Other Theories of Reimbursement and Recoupment*^[158]

An insurer may confront situations in which recovery of payments made to third parties is appropriate.

^[159] These situations generally occupy the following distinct areas:

- Recovery from the insured directly where the insurer and insured had previously agreed that the insured would reimburse the insurer, should the insured receive payment from a third party.^[160]
- At the time of making payment, the insurer understood that payment was required by the coverage terms of the policy; however, as a result of a change in circumstances, the insurer was not obligated to make payments under the policy (e.g., the cost of defense was paid until coverage issues were resolved).^[161]
- Recovery of expenditures that were made, knowing they were not required by the policy, because the payments that were required and those that were not required were intertwined.^[162]
- Recovery of payments that were made as a mistake by the insurer; the insurer never intended payment, paid the wrong entity, or paid the wrong amount (overpayment).^[163]

- Payments were made because of misrepresentation or fraud by or on behalf of the insured.^[164]

Many of the concepts that establish this right of recoupment are likewise in a state of flux. In order to define the parameters of these recovery actions, the practitioner must begin by understanding the concepts themselves.

Any time an insurer can obtain recover proceeds wrongly paid to the insured or third parties, total claims costs are reduced. The recovery of these proceeds, however, may not be cost-effective in all situations, and the insurer should assess whether the cost of instituting such actions outweighs the foreseeable benefits.^[165]

The ultimate goal of reimbursement and recoupment actions is to reduce the premiums charged for liability insurance. As one commentator has observed, “[t]o the extent it is cost effective to pursue reimbursement and thereby reduce total claims costs, the insurer should be able to offer less expensive liability insurance to policyholders.”^[166]

Despite the potential for saving costs, an insurer may be hesitant to seek reimbursement if it is threatened with a potential bad faith claim for being proactive and suing the insured directly. In *Old Republic Insurance Co. v. FSR Brokerage, Inc.*,^[167] the insurer sought reimbursement for defense costs it had expended with respect to claims it contended were partially outside the policy, citing *Buss v. Superior Court*.^[168] The insurer also alleged causes of action for fraud, breach of contract, and bad faith against the insured. With respect to the reimbursement issue, the court ruled that there were questions of fact about whether the insurer had waived its right of reimbursement. Ultimately, the insured pursued only a single claim for bad faith against the insurer, “based on the theory that the fraud claim in Old Republic’s [the insurer] second amended complaint was an act of bad faith.”^[169] In response, the insurer alleged that the claim constituted an improper claim of malicious prosecution and was barred by the absolute privilege provided by California Civil Code section 47. The jury was later instructed as follows:

Before an insurance company sues its insured for fraud, the insurance company owes a duty of good faith and fair dealing to the insured to reasonably and carefully investigate both the facts and law to determine that it has proper grounds, reasonable cause, to charge the insured with fraud.

^[170]

The court ultimately dismissed the insured’s bad faith claim because it did not allege that the insurer acted *unreasonably* in investigating or paying the underlying insurance claim; the mere allegation that the

insurer's lawsuit constituted bad faith was insufficient. The court further held that the insurer's action was protected by California Civil Code section 47. Interestingly, the court also noted that the insured is "nonetheless protected from abusive litigation by cost of litigation against the insurer (sic), and by the availability of an action for malicious prosecution and other remedies consistent with the absolute privilege under Civil Code Section 47."^[171] Consequently, as long as the insurer reasonably and carefully investigates the potential action against the insured and has reasonable cause to institute the action, an insurer should not hesitate to sue its insured directly or raise the appropriate counterclaim.

E. *Conclusion*

The dangers of a bad faith claim are ever present if an insurer does not implement a proactive plan to prevent such claims from the outset. Significant exposure is likewise threatened if the insurer has not designed a proactive approach to challenge the trial tactics of the insured, including the insurance expert. However, the time frame between the initial claim and the trial of the claim is equally important. When faced with a potential claim, the claims professional should immediately seek the input of a practitioner familiar with bad faith litigation; together they will comprise the strategic defense team. That team will explore the viability of all contract defenses and determine as well the availability of comparative bad faith and/or reverse bad faith defenses. The team will also discern whether any action or inaction by the insured adversely affected or influenced the insurer's position. No stone should remain unturned in the effort to convince the court and the jury that the implied covenant of good faith and fair dealing is a "two-way street" on which the insured is "responsible" for its own actions. Further, when it is cost effective, the insurer should follow the flow of dollars from its pocket to the insured or other third parties, seeking reimbursement for dollars initially expended in the appropriate case. To forestall designing an approach to bad faith litigation will not only allow the insured to dictate the processes initially, it could also foreclose affirmative relief allowed to the insurer by the courts and statutes. At the very least, the team should consider whether it is beneficial to be *proactive* or *reactive*. As part of its plan, the team must determine whether to retain its own expert and how to challenge any expert retained by the opposing party.

III.

INSURANCE EXPERTS: THE NEED FOR A PROACTIVE CHALLENGE

A. *The Issue*

The admissibility of expert witness testimony and the documentary evidence upon which such testimony is based are currently subject to a myriad of challenges in all types of litigation, both at the state and federal levels. A clear understanding of the application of *Daubert v. Merrell Dow Pharmaceuticals, Inc.*,^[172] *General Electric v. Joiner*,^[173] and *Kumho Tire Co. v. Carmichael*,^[174] is critically important to defense practitioners and their ability to exclude expert evidence offered by the plaintiff/policyholder/insured. The wrangling about whether *Daubert* standards apply only to scientific evidence or whether the *Daubert* gatekeeping function applies equally to nonscientific evidence has been laid to rest. Consequently, as noted below, those practicing in the insurance-related defense and coverage arenas must be prepared to challenge a plaintiff's proof in bad faith, claims handling, and policy interpretation cases. Similarly, counsel must be prepared to challenge the documentary evidence upon which any expert opinion is based that is offered by plaintiff's counsel to justify plaintiff's interpretation of the policy. Of course, counsel for the insurance company should be aware that the insurer/defense expert's testimony undoubtedly will undergo similar challenge.

A proactive approach that challenges expert testimony within the nonscientific, insurance-related fields must begin with an understanding of *Daubert*, *Joiner*, and *Kumho*. However, if the applicable state jurisdiction does not follow *Daubert* and its progeny, the practitioner should consider the test articulated in *Frye v. United States*,^[175] or perhaps a combination of the two. Though it is beyond the scope of this article, the practitioner should also consider whether the expert is qualified in his or her field of expertise. This article will next consider a historical analysis of these cases together with their applicable tests. Defense counsel will be urged to consider several projects covering application of these tests to expert evidence within the context of the traditional insurance case.

B. *The Standard*

1. *Daubert*, et al.

Any analysis of the standard that courts will apply to "junk science" and "junk expert testimony" must begin with *Daubert*, *Joiner* and *Kumho* since difficult questions clearly remain regarding how these opinions apply outside scientific disciplines. Junk science has been defined as "jargon-filled, serious-sounding deception."^[176]

a. *Daubert v. Merrell Dow Pharmaceuticals, Inc.*^[177]

In *Daubert*, the parents of children suffering birth defects allegedly caused by the drug Bendictin instituted an action against the manufacturer of that drug. Bendictin was an anti-nausea drug used by mothers during pregnancy. Procedurally, the defendant moved for summary judgment on the issue of causation contending there was no link between the use of Bendictin and the alleged birth defects. To support its motion, defendant offered the affidavit of a scientific expert. Plaintiff countered this proof with affidavits from eight expert witnesses who argued that there was a causal link. The district court granted the defendant's motion and plaintiffs appealed to the Ninth Circuit Court of Appeals. Affirming the lower court's holding, the Ninth Circuit cited *Frye v. United States*,^[178] noting that scientific testimony would only be admitted if it were "generally accepted in the relevant scientific community."^[179] Plaintiff petitioned the United States Supreme Court contending that since *Frye*, the United States Congress had enacted the Federal Rules of Evidence (specifically Rules 104(a) and (b) and Rule 702), which arguably liberalized evidentiary standards. These rules provide as follows:

Federal Rule of Evidence 104(a):

Preliminary questions concerning the qualifications of a person to be a witness . . . or the admissibility of evidence shall be determined by the Court.

Federal Rule of Evidence 104(b):

When the relevancy of evidence depends on the fulfillment of a condition of fact, the Court shall admit it upon, or subject to, the introduction of evidence sufficient to support a finding of the fulfillment of the condition.

Federal Rule of Evidence 702:

If scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify thereto in the form of an opinion or otherwise.

Recognizing that the Federal Rules of Evidence were intended to be more liberal than the historical *Frye* test, the Supreme Court noted that the *Frye* court's "rigid general acceptance requirement would be at odds with the liberal thrust of the Federal Rules."^[180] With that said, the Court defined the trial court's "gatekeeping" function and its obligation to exclude evidence based only on "subjective belief or unsupported

speculation.”^[181] The Court also enumerated several factors for the trial court to consider when analyzing the reliability of evidence:

1. Can the theory or technique be tested or has it been tested?
2. Has the theory or technique been subject to peer review and publication?
3. Is there a known or potential rate of error?
4. Do standards and controls exist and are they maintained?
5. Has the theory been generally accepted?^[182]

The Court emphasized, however, that these factors are “general observations” that should not be considered a definitive test.^[183] The Court also cautioned that it had only addressed scientific expert evidence; it was not addressing technical or other specialized knowledge. Legal analysts immediately questioned whether the *Daubert* “gatekeeping” function extended to other types of expert testimony.

In his dissenting opinion, Justice Rehnquist initiated this same concern: “[D]oes all of the dicta apply to an expert seeking to testify on the basis of ‘technical or other specialized knowledge’ the other types of expert knowledge to which Rule 702 applies, or are the ‘general observations’ limited only to scientific knowledge?”^[184] Other commentators speculated as well.^[185] Further, there developed a significant split among the various lower courts about how *Daubert* would be interpreted and whether it would apply to nonscientific evidence.^[186]

It should be noted that the Supreme Court remanded *Daubert* to the Ninth Circuit Court of Appeals. On remand, the Ninth Circuit found that the evidence was inadmissible. In addition to the *Daubert* factors, it noted that expert testimony is presumptively unreliable if the research was conducted in anticipation of, rather than independent of, the litigation.^[187]

b. *General Electric v. Joiner*^[188]

The *Daubert* Court also left unresolved the issue of what standard should be applied by an appellate court when reviewing a trial court ruling on the admissibility of evidence. In *Joiner*, the Supreme Court addressed this issue and resolved the conflict among the various districts that had developed after *Daubert*.^[189]

The *Joiner* dispute involved a plaintiff's claim that his cancer was caused by exposure to PCB and chemical fumes. The district court had ruled that a causal link did not exist between the exposure and the cancer. On appeal, the Eleventh Circuit reversed the district court's ruling, applying a de novo standard of review. The United States Supreme Court rejected this standard, however, ruling that the decision of the district court should not be revised unless that court abused its discretion.^[190] Of significance, the Court reaffirmed the *Daubert* standard but without the clarification that had been anticipated:

[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence, which is connected to existing data, only on the *ipse dixit* of the expert. A Court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.^[191]

Subsequent to *Daubert* and *Joiner*, confusion still existed among the federal district and state courts regarding which standard to apply.^[192] Further, the Court did not answer the question posed by Chief Justice Rehnquist in *Daubert*: Did the Court's ruling apply to nonscientific and other technical evidence? As a result, after *Daubert* and *Joiner*, courts in the various circuits answered this question differently. For example, the Second, Ninth, and Tenth Circuits held that *Daubert* was limited to scientific testimony and not applicable to experience-based testimony.^[193] In contrast, the Fifth, Sixth, Seventh, and Eighth Circuits authorized the use of *Daubert* factors to analyze admissibility of expert evidence, both scientific and nonscientific in nature.^[194]

c. Kumho Tire Co. v. Carmichael^[195]

Recognizing the foregoing conflict, the Supreme Court in *Kumho* confronted the issue directly, analyzing whether the "gatekeeping" function of the district court applied to scientific, nonscientific and other technical evidence. The *Kumho* plaintiffs had been injured as the result of a tire blowout on a minivan. They sued the tire manufacturer, claiming that either a design or manufacturing defect caused the blowout. In support of their theory, plaintiffs offered the testimony of a tire expert. On motion of the defendant, the trial court excluded the tire expert's testimony utilizing *Daubert* factors (general acceptance, rate of error, peer review and publication). The Eleventh Circuit reversed, holding that *Daubert* was limited to scientific evidence and did not apply to the tire expert's testimony since that testimony was skill- or experience-based.^[196] The United States Supreme Court reversed the Eleventh Circuit, noting that the language of Rule 702 makes no distinction between

“scientific” knowledge and “technical” or “other specialized” knowledge. Further, the high Court determined that the evidentiary rationale underlying the basic *Daubert* “gatekeeping” function was not limited to “scientific” knowledge:

[W]e conclude that the trial judge must have considerable leeway in deciding in a particular case how to go about determining whether particular expert testimony is reliable. That is to say, a trial court should consider the specific factors identified in *Daubert* where they are reasonable measures of the reliability of expert testimony.”^[197]

Citing *Joiner*, the Supreme Court further noted that the appellate courts must apply an abuse of discretion standard when reviewing a trial court decision to admit or exclude expert testimony.^[198] The Court then applied the abuse of discretion standard to the relevant facts, concluding that the testimony of plaintiffs’ tire expert was properly excluded by the trial court under that standard.

Several recent cases have considered the application of *Daubert* standards post-*Kumho*. The case of *Jaurequi v. Carter Manufacturing Co.*^[199] involved the testimony of a mechanical engineer and human factors expert regarding safety barriers and improper safety warnings. The court there noted that when applying the *Daubert* standard to all types of expert testimony, the trial court is left with “great flexibility in adapting its analysis to fit the facts of each case.” Further, the trial court did not abuse its discretion when excluding evidence that was nothing more than “unabashed speculation.”^[200]

The United States Supreme Court later refused to grant the plaintiff’s petition for *certiorari* in *Moore v. Ashland Chemical, Inc.*^[201] This case involved a doctor’s causation testimony based on clinical assessment and diagnosis of the plaintiff’s illness following exposure to chemical toxins. Relying on *Daubert* and Federal Rule of Evidence 702, the district court excluded the testimony. The Fifth Circuit reversed, however, noting that *Daubert* factors do not apply to clinical medicine which is not hard science. An en banc court subsequently abandoned the panel determination, holding that no such distinction exists and that Rule 702 and *Daubert* apply to both scientific and nonscientific expert testimony.

The court in *Johnson v. District of Columbia*^[202] refined the issue further. That case involved scalding injuries to an infant child amid allegations that a water heater malfunction caused the injuries. Pursuant to the defendant’s motion *in limine*, the trial court excluded the testimony of plaintiff’s plumbing expert on grounds that he was only experienced in the installation of water heaters, did not have any experience in the design or

control function, and was unfamiliar with commercial heaters. The court of appeals determined that as long as the trial judge has the facts necessary to assess the expert's qualifications, the judge can admit or exclude expert testimony without a hearing, based on those facts contained in the record or the attorney's offer of proof.^[203]

d. *Frye v. United States*^[204]

Under *Frye*, the sole determinant of the reliability and admissibility of an expert's testimony is whether the expert's testimony is based on scientific principles or procedures, or whether the principles or procedures have sufficiently gained "general acceptance" in the specific field to which the principles or procedures relate. Decided over seventy-five years ago, the attorneys representing Frye attempted to admit expert testimony on the reliability of a systolic blood pressure test to disprove that Frye committed a murder. The federal court excluded the offer of proof because the test had not "gained general acceptance in the particular field to which it belongs;" therefore, it was inadmissible because it was "experimental" as opposed to "demonstrable."^[205] The *Frye* standard is often considered less flexible than the *Daubert* standard. Under *Frye*, the party offering the scientific evidence must conclusively show general acceptance. If the proof is accepted only by a minority of scientists in the applicable/relevant field, such expert proof would be excluded. Under *Daubert*, however, proof that is accepted by a minority of scientists would provide only a basis to impeach the expert witness.^[206]

C. *Application to Insurance Issues*

1. General Principles

There is little doubt that the insurance industry held serious interest in *Daubert* and its progeny because inconsistencies that developed after *Daubert* could have adversely affected the standards by which claims professionals, underwriters, and the insurance industry as a whole would be judged. For example, concerns of the American Insurance Association and the National Association of Independent Insurers were expressed in their amici curiae briefs,^[207] where they encouraged the Court to extend *Daubert* standards to "applied science," including insurance issues within the context of Y2K litigation.^[208] The ultimate concern was whether the testimony of an insurance expert, which is based on general personal experience, skill, and knowledge, would withstand application of the relevant standards.

Under existing standards, it must be determined initially whether the testimony offered assists the trier of fact in understanding the issues at hand and leaves undisturbed the province of the jury. The case of *Buckner v.*

Sam's Club, Inc.^[209] confirms this analysis when discussing the testimony of a safety management expert.^[210] Within the insurance context, the court of appeals in New York has traditionally held that “the opinions of experts, which intrude on the province of the jury to draw inferences and conclusions are both unnecessary and improper.”^[211]

The court in *Kulak v. Nationwide Mutual Insurance Co.*^[212] similarly excluded expert testimony when deciding whether an insurer acted in bad faith in allegedly failing to settle:

While it might be suggested that an experienced trial attorney . . . who has had frequent occasion to observe the results of juries' deliberations in personal injury actions might be expected reliably to predict the outcome in a particular case, we know of no empirical support for such a conclusion. Moreover, any such result would be based on exposure rather than expertise; and would treat of subject matter calling for no special scientific or professional education, training or skill.^[213]

After recognizing the underlying need for special qualifications *and* testimony, the court further noted: “[a]ny experience advantage enjoyed by such witnesses would not establish the inability or incompetence of jurors, on the basis of their day-to-day experience and observation, to comprehend the issues, to evaluate the evidence, and finally to estimate the likely outcome of a specific action.”^[214] Citing Federal Rule of Evidence 702, the one dissenting judge in *Kulak* endorsed an approach that takes a more realistic view of the need for expert testimony in today's complex society. He also identified areas where expert testimony is necessary in a bad faith case.^[215]

With this overview, the practitioner should next assess how the *Daubert* standards become operative. What is certain is that each situation must be assessed on a case-by-case basis because not all *Daubert* factors will apply to all experts and, in fact, none will apply in some cases. As one commentator has observed:

[T]he *Daubert* factors may or may not apply in each case. Rather than employ a mechanistic application of specific factors, courts should focus on *Daubert's* goal, which is to make certain that the expert, whether basing testimony on professional studies or personal experiences, employs the same level of intellectual rigor that characterizes the practice of an expert in the relevant field.^[216]

As noted in *Tyus v. Urban Search Management*,^[217] “the measure of intellectual rigor will vary by the field of expertise, and the way of demonstrating expertise may vary.”^[218] However, the court in *Tyus* also concluded that: “In all cases . . . the district court must ensure that it is dealing with an expert, not just a *hired gun*.”^[219]

While there is limited case law to govern whether a particular “insurance expert” meets the applicable *Daubert* tests, there are several recent cases within the coverage context that provide some guidance. In each case under scrutiny, the practitioner should determine whether the expert’s opinion is based on mere speculation or whether the expert used the “types of information, analyses, and methods relied on by experts in his field.” Also, “the information that he gathers and the methodology he uses must reasonably support his conclusions.”^[220]

When applying the foregoing principles, several interesting cases that postdate *Daubert* but predate *Kumho* should be considered. These address whether the *Daubert* standards are applicable to expert testimony concerning claims-handling procedures. In *Reedy v. White Consolidated Industries, Inc.*,^[221] the insured alleged, among other things, that his employer acted in bad faith in refusing to pay workers’ compensation benefits. The plaintiff had designated two individuals or experts to testify on claims-handling procedures, and the defendant moved to strike the testimony of these witnesses. In denying the defendant’s motion, the court made several statements that will assist the practitioner in determining when the testimony of “insurance experts” should be allowed:

1. An individual can qualify as an expert where that individual possesses significant knowledge gained from practical experience, even though academic qualifications in the particular field of expertise may be lacking.
2. The central issue is whether the expert’s testimony will assist the trier of fact; merely telling the jury what result to reach is not helpful.
3. Competency goes to weight, not admissibility.
4. Expert testimony must be reliable and relevant under *Daubert*.
5. The witness should have specialized knowledge about relevant activities in the case with which most jurors are not familiar.

The court held that the “claims adjusting procedure is . . . something about which the average juror is unlikely to have sufficient knowledge or experience to form an opinion without expert guidance, thus expert testimony

would not be superfluous.”^[222] In reaching its decision to permit expert testimony about whether the defendant’s claims procedure was usual and appropriate, the court reviewed the expert’s practical experience with claims adjustment and the types of claims processed. However, while the testimony of the two experts was admissible, the defendant was still “entitled to pursue further challenges to these expert’s skill or knowledge in order to attack the weight to be accorded their expert testimony.”^[223]

In *United States Fidelity & Guaranty Co. v. Sulco, Inc.*,^[224] the court likewise considered the proffered expert testimony of a claims processing manager and, without discussing the *Daubert* factors, allowed it as sufficient. Again, in *Kraeger v. Nationwide Mutual Insurance Co.*,^[225] the court considered the testimony of the insured’s bad faith expert and denied the insurer’s motion *in limine*. In doing so, the court made certain observations that are helpful in assessing the parameters of a bad faith expert’s testimony:

1. Testimony about how insurance claims are managed and evaluated and the statutory or regulatory standards to which insurance companies must adhere could be helpful to the jury in evaluating whether the claim was handled in bad faith.
2. The expert witness cannot provide legal conclusions that the insurer violated a particular statute or that the insurer acted in bad faith.
3. The expert witness can testify that, based upon expertise and experience, the insurer had no reasonable basis for its actions.

In reaching its conclusion, the court specifically determined that the *Daubert* factors did not apply to this type of testimony.

There are two recent post-*Kumho* nonscientific cases that likewise provide some guidance to those practitioners who litigate insurance issues. In *Concord Boat Corp. v. Brunswick Corp.*,^[226] the court considered the admissibility of testimony from the plaintiff’s economic expert. In support of its damage claim in this antitrust case, the plaintiff offered testimony concerning a particular economic model. Allowing the testimony of the economic expert, the court noted that *Daubert*’s focus is solely on technique and methodology; not the conclusions they generate. It therefore held: “[p]laintiffs have amply demonstrated the soundness of the court model as a fundamental, time-tested economic tool that has been widely accepted for years by reputable economists.”^[227]

In the antitrust case of *City of Tuscaloosa v. Harcros Chemicals, Inc.*,^[228] the Eleventh Circuit considered the nonscientific testimony of a certified public accountant and the testimony of a statistician and held: “[w]e conclude that the district court abused its discretion in excluding Garner’s [CPA] testimony We further conclude that the district court’s interpretations of *Daubert* and of Rules 104 and 702 . . . were erroneous as a matter of law.”^[229] With respect to the statistician’s testimony, the court excluded portions of his testimony only because such testimony was outside his competence and the methodology was flawed.^[230]

It should be noted that the defense bar also has been successful in excluding the insured/policyholder’s expert in the following cases:

- *Hyde Athletic Industries, Inc. v. Continental Casualty Co.*^[231] The court in this case excluded the plaintiff’s expert testimony when determining whether the environmental containment was “sudden or accidental” or whether it occurred over a long period of time. The exclusion of the evidence initially was based on inconsistencies between the expert’s deposition testimony and the affidavits submitted on the summary judgment motion. In addition, the court noted that it was “concerned that Robertson’s opinion would be inadmissible at trial under Federal Rule of Evidence 702 because it may not meet the standards outlined in *Daubert*”^[232]
- *Brown v. Auto-Owners Insurance Co.*^[233] This case involved expert testimony by a civil engineer regarding the structural damage to a warehouse, which was alleged to be speculative. In rejecting the expert testimony proffered by the insured/policyholder, the court noted that “the expert’s testimony must be grounded in the methods and procedures of science and not subjective belief or unsupported speculation.”^[234] Because the testimony was based on nothing more than the witness’s subjective belief and personal observations regarding the cause of the damages, rather than mathematical calculation or scientific methodology, it was excluded.

To the contrary, there exist several other cases where the insurer has not been successful in excluding the testimony of the insured/policyholder’s expert or where the insurer’s own expert testimony has been excluded:

- *Michigan Millers Mutual Insurance Co. v. Benfield.*^[235] In this case, the testimony of the insurer’s fire and origin expert was excluded because it was not sufficiently reliable for admission

under *Daubert*. Specifically, the court rejected the opinion evidence because it was not supported by reliable procedure and scientific methodology.

- *Douglas v. State Farm Lloyds*.^[236] Though the issue here did not arise in the *Daubert* context, its determination affects the use of experts in insurance cases. In this “failure to investigate and settle” case, the court noted that “an insurer’s reliance upon an expert report, standing alone, will not necessarily shield the carrier if there is evidence that the report was not objectively prepared or the insurer’s reliance on the report was unreasonable.”^[237]
- *Aetna Casualty & Surety Co. v. Dow Chemical Co.*^[238] This environmental case involved a claim by an insurance carrier that it was prejudiced because the insured’s report regarding the removal of underground storage tanks did not contain information as to when releases or contamination occurred. The court noted that because the insurer did not utilize an expert on hydrogeology to establish the nature and timing of the discharge, the insurer’s claim for prejudice was in doubt.
- *Watts v. Organogenesis, Inc.*^[239] In a case involving the construction and interpretation of the phrase, “underlying medical condition,” within a medical insurance contract, the insured’s doctor had testified that dysreflexia was an underlying medical condition. Accepting the insured’s expert testimony, the court noted: “If the phrase is a term of art, then a medical expert’s unrebutted designation of the dysreflexia as such is sufficient as the last word on this issue. If it is not, then use of the phrase in the plan document is ambiguous, and therefore should be construed in accordance with the singular/plural rule”^[240]

By virtue of the determination in *Kumho*, the rules espoused by these cases also apply to nonscientific evidence. Within the insurance context, these include bad faith, policy interpretations and claims-handling cases.

As the various district and state courts begin applying the *Kumho* analysis of *Daubert* to nonscientific evidence, inconsistencies between rigid application of the standards and a flexible approach should dissolve. For example, in *Moore v. Ashland Chemical, Inc.*,^[241] the Fifth Circuit sitting en banc likely applied *Daubert* too rigidly when it held that the district court had discretion to exclude the causation testimony of the plaintiff’s clinical physician because there existed an “analytical gap between the causation opinion and the scientific knowledge and data that were cited in support.”^[242] “Courts that have applied *Daubert* broadly have

demonstrated that, as a general framework, *Daubert* plays an important role in requiring experts to do more than ‘come to court with their credentials and a subjective opinion.’”^[243] Since inconsistency is still a possibility, it is absolutely necessary that the practitioner grasp the standards applied in both state and federal courts within the applicable jurisdictions. An example of such analysis is included below. It considers the status of New York law subsequent to *Daubert*, *Joiner*, and *Kumho*. Such an analysis should be undertaken within the practitioner’s relevant jurisdiction.

D. *New York Approach*

1. State Court

a. *Scientific Testimony*

New York state courts have not yet adopted the *Daubert* standard as enhanced by *Joiner*, or *Kumho*. Specifically, the New York Court of Appeals has not embraced the *Daubert* standard of scientific reliability; instead, it has retained the *Frye* “general acceptance” test. In *People v. Wesley*,^[244] the court noted in a footnote that *Daubert* was not applicable, remarking that, under *Frye*, the particular procedure need not be unanimously “endorsed” by the scientific community if it is “generally accepted as reliable.”^[245] The *Frye* standard became the basis for New York’s two-part test on the admissibility of scientific expert testimony.^[246] Under the first prong of the test, the proffered expert’s testimony must be based upon scientific knowledge and skill that is not within the scope of the jury’s ordinary training or intelligence. The expert need only have gained knowledge or expertise (formal or otherwise) that would assist the jury in interpreting the issues before it. If the proffered proof is based solely on common knowledge or intelligence, the testimony should be excluded because jurors can form these same reasonable opinions.

The second prong requires that the expert’s testimony be based on scientific principles or procedures under the “general acceptance” test.^[247] It is within the province of the trial court to determine whether the expert’s testimony is both necessary to assist in the jury’s interpretation and whether the expert’s theory has gained general acceptance. Once that determination is made, the weight accorded to the expert’s testimony is left to the jury. The court traditionally has conducted a “*Frye* hearing” during which each party presents its position to support or challenge admissibility. One court has noted that such a hearing is not necessary, deciding the admissibility issue without a formal hearing.^[248]

b. *Nonscientific Testimony*

Consistently, the courts in New York have held that the *Frye* “general acceptance” test is not applicable to nonscientific or non-novel evidence.^[249] In *Wahl v. American Honda Motor Co.*,^[250] when considering the testimony of an engineer regarding the design defects of an ATV, the court ruled as follows: “inasmuch as the testimony is that of an engineer, and . . . is based upon . . . recognized technical or other specialized knowledge, the Court finds that the stricter general acceptance standard of *Frye* is not applicable. The Court will apply the reliability standard as derived from *Daubert* and *Kumho Tire*.”^[251]

Following suit, another court in *Clemente v. Blumenberg*^[252] questioned the continued application of *Frye* not only to scientific, but to nonscientific expert testimony as well:

[T]he accelerated pace at which science travels is today far faster than the speed at which it traveled in 1923 when *Frye* was written. Breakthroughs in science which are valid may be relevant to a case before the courts. Waiting for the scientific community to “generally accept” a novel theory which is otherwise valid and reliable as evidence may deny a litigant justice before the court.^[253]

Thus, when considering the testimony of a biomedical engineer, the court analyzed the issues under both *Frye* and *Daubert* standards:

[T]his court finds that the proffered biomedical engineer is qualified as an expert in biomedical engineering based upon his professional training and may render an opinion as to the general formula of forces upon objects. . . . However, he may not render an opinion based on his report and testimony at the *Frye* hearing because the source of the data and the methodology employed by him in reaching his conclusion is not generally accepted in the relevant scientific or technical community to which it belongs.^[254]

The court continued: “applying the *Daubert/Kumho* factors . . . this court finds that the data and the methodology employed by the biomechanical engineer are not scientifically or technically valid.”^[255] In addition to these findings, the court observed:

A trial judge's role as a gatekeeper of evidence is not a role created by *Daubert* and rejected by the Court of Appeals; it is an inherent power of all trial court judges to keep unreliable evidence ("junk science") away from the trier of fact regardless of the qualifications of the expert. A well-credentialed expert does not make invalid science valid merely by espousing an opinion.^[256]

By virtue of the *Clemente* decision, at least one New York judge is willing to move away from the rigors of *Frye* to a more liberal approach.

2. Federal Court

Since the Supreme Court's decision in *Daubert*, there have been only two federal court cases in New York that have addressed the *Daubert/Kumho* standards. In *Gray v. Briggs*,^[257] which involved a dispute between an attorney and former law firm employees who had participated in the firm's pension plan, it was alleged that defendants breached a fiduciary duty in violation of the Employee Retirement Income Security Act (ERISA). Plaintiff had retained an expert who asserted, among other things, that defendants had violated ERISA, made speculative personal investments, and violated industry standards against churning. The defendants challenged the plaintiff's expert and moved to preclude the testimony. Citing *Kumho*, the court rejected the expert's testimony and concomitant report on various grounds:

1. The testimony was outside the expert's expertise;
2. The expert lacked the qualifications to express the opinion for which his testimony was offered;
3. The expert's opinion was nothing more than strained speculations or bare legal conclusions; it was without sufficient evidentiary basis to be helpful to the court or reliable.

When applying the *Kumho* standard, the court offered that expert testimony is admitted under Federal Rule of Evidence 702 where it will assist the trier of fact to understand the evidence or determine a fact in issue. Further, an expert must be qualified to testify (i.e., by knowledge, skill, experience, training or education). As noted in *Kumho*, the expert must have "sufficient specialized knowledge to assist in deciding the particular issue in the case."^[258]

Another district court judge considered *Daubert* and its progeny in *Grdinich v. Bradlees*,^[259] which involved a claim by a plaintiff who was injured while shopping at defendant's store when ironing boards fell from a display case. The plaintiff had retained an expert to testify that defendant ignored or failed to follow the

industry guidelines applicable to self-service department stores. The defendant challenged the admissibility of the expert's testimony. Citing the "gatekeeping" function articulated by *Daubert* and *Kumho* (application of *Daubert* to technical and other specialized knowledge), the court noted that it must decide "whether this particular expert [has] sufficient specialized knowledge to assist the 'jurors in deciding the particular issue in the case.'"^[260] The court precluded the expert testimony because:

1. none of the *Daubert* factors were present, including that of "general acceptance" within the relevant expert community; and
2. there were no countervailing factors which favored admissibility which so as to outweigh those identified in *Daubert*.

As a result, the testimony was precluded because it was neither reliable nor relevant.

E. *Reliable Data*

It is obvious that an expert cannot testify in a vacuum. The court in *Joiner*^[261] focused on the "analytical gap" concept, excluding expert testimony that exposure to certain chemicals caused lung cancer because the expert's opinion was based on animal epidemiological studies with no explanation as to how such studies applied to humans. In *Moore v. Ashland Chemical*,^[262] the Fifth Circuit conducted a similar analysis, excluding the expert testimony of a physician who did not rely on established studies to support his opinion. These cases illustrate the significance to admissibility and relevancy of research studies and data upon which the expert relies.

The recent decision of the Tenth Circuit in *Roberts v. Farmers Insurance Co.*^[263] provides a case in point. At issue on appeal was whether the district court had properly granted the insurer's motion for summary judgment on grounds that the policy contained a "resident exclusion," which precluded the insured from recovering for personal injuries sustained at her home. The insured contended that even though the policy excluded such coverage, she should be entitled to recover under the doctrine of reasonable expectations because the exclusion was either ambiguous or hidden in the policy (i.e., printed in small font and buried on page seven amid a laundry list of exclusions). Attempting to prove that the resident exclusion was ambiguous, the insured offered the expert testimony of a psychology professor and an accompanying survey of 126 college students. The survey was conducted by the professor and purportedly concluded that, after reading the exclusion, sixty-

nine percent of the students believed that the policy provided coverage. The district court excluded the survey noting:

The plaintiff's only support of a claim of ambiguity is the survey of Dr. Donovan, intended to show that the contract must be ambiguous if a group of college students find it to be so. This Court disagrees. The Oklahoma Supreme Court has admonished courts not to indulge in forced or strained construction to create and thus construe ambiguities where they do not otherwise exist. Because this Court must determine if the policy is ambiguous as a matter of law, the survey of Dr. Donovan is inappropriate and irrelevant to establish the existence of an ambiguity.^[264]

Affirming the district court's refusal to consider the survey evidence, the Tenth Circuit noted that under Oklahoma contract law, whether an insurance policy is ambiguous is decided as a matter of law. Extrinsic evidence can be considered only after a finding of ambiguity. In the instant case, however, the court determined that the residence exclusion was not ambiguous; therefore, the survey was irrelevant.

What would have happened had the court determined the existence of an ambiguity? Would the survey of college students have been admissible? The circuit court noted that "well-conducted public opinion surveys may play an important role in the courtroom."^[265] The court also referenced two cases cited by the insured pertaining to such surveys. In *Brunswick Corp. v. Sprint Reel*,^[266] a trademark case, the confusion between two products surfaced as a legal issue. The trial court admitted a survey, in addition to other evidence, when determining the likelihood of confusion about the source of a product with a similar trademark or trade dress. The survey involved individuals in shopping areas within five cities who were shown a Sprint SR210 reel and asked to name the manufacturer. The Tenth Circuit held that the district court did not abuse its discretion in admitting the survey. It noted: "[s]urvey evidence may be admitted as an exception to the hearsay rule if the survey is material, more probative on the issue than other evidence, and if it guarantees trustworthiness."^[267] When determining materiality in cases involving confusion over product source, a survey may be the only available method of demonstrating the public state of mind. A survey is considered *trustworthy* when it is conducted according to accepted principles.^[268] In *Brunswick*, the survey was apparently conducted using reasonably acceptable market research techniques. The court therefore admitted the survey on the issue of confusion and further indicated that any technical or methodological deficiencies would affect its weight; not its admissibility.

The second case referenced by the Tenth Circuit was *Harold's Stores, Inc. v. Dillard Department Stores, Inc.*,^[269] which involved alleged injury to the plaintiff's public reputation and goodwill. Plaintiff there utilized the services of a marketing professor as an expert. Based on the results of a survey of college-aged women who had visited the plaintiff's store or examined its catalog and visited the defendant's store, that expert calculated damages due the plaintiff nationwide because of defendant's alleged copyright infringement and antitrust actions. Again, the appellate court determined that the district court did not abuse its discretion in admitting the survey as an exception to the hearsay rule. The survey was determined to be material, probative to the issue of copyright infringement damages, and conducted according to generally accepted survey principles. The court further noted:

The survey should sample an adequate or proper universe of respondents. "That is, the persons interviewed must adequately represent the opinions which are relevant to the litigation." The district court should exclude the survey "when the sample is clearly not representative of the universe it is intended to reflect."^[270]

With respect to the insured's survey offer in *Roberts*, the court determined that the survey would not be allowed even if it was determined that the policy was ambiguous: "In the case before us, there is no link between the legal question and the survey evidence; what the public expects from an insurance policy is simply not relevant to the legal question of whether the contract is ambiguous."^[271] The court did not decide the application of the reasonable expectation doctrine because that doctrine only applied where the court found the policy ambiguous or the exclusion hidden. Here, the insured failed to make a *prima facie* case.

It would appear from these authorities that courts will not admit survey-type evidence or other data, studies, or methodological evidence where there is no "link" between the offered evidence and the legal issue before the court. This is true whether a bad faith standard, claims-handling procedure, or policy interpretation is at issue. It would seem that this "link" is the same "analytical gap" that the court referred to in *Joiner* when it stated: "A court may conclude that there is simply too great an analytical gap between the data and the opinion offered."^[272]

F. *Procedural Attack*

Justice Breyer, in his concurring opinion in *Joiner*, entered an interesting observation:

[J]udges have increasingly found in the Rules of Evidence and Civil Procedure ways to help them overcome the inherent difficulty of making determinations about complicated scientific or otherwise technical evidence. Among these techniques are an increased use of Rule 16's pretrial conference authority to narrow the scientific issues in dispute, pretrial hearings where potential experts are subject to examination by the court, and the appointment of special masters and specially trained law clerks.^[273]

The procedural mechanisms referenced by Justice Breyer are generally initiated at the discretion of the court and often occur well into the litigation process. For example, the circuit court of appeals in *Harold Stores* stated: "we cannot conclude the district court abused its discretion in admitting the survey. The district court conducted an extensive voir dire of Dr. Howard and satisfied itself that the survey met the appropriate standard."^[274] In light of this observation, defense counsel should ask whether any procedural mechanisms are available that can be implemented early in the litigation process to facilitate the economies of handling these types of cases.

The parties and the court must develop a procedural mechanism that challenges the testimony of plaintiffs' insurance industry experts sooner rather than later. Such a procedural device has been developed within recent years in toxic tort and environmental cases and should be tested within the context of other cases as well. *Lore v. Lone Pine Corp.*^[275] is instructive. This case involved a toxic tort claim against a landfill operator and the generators and haulers of toxic materials to that landfill. The plaintiffs alleged that their property values depreciated because the landfill existed. They also claimed personal injuries from exposure to various toxic substances. The defendants in *Lore* served an order to show cause seeking a case management order requiring the plaintiff to furnish "basic facts" on the causation issues to support their claims of personal injury and property damage. The order sought by the defendants has come to be known as a "*Lone Pine* order." Since the plaintiffs failed to provide the expert evidence required by the case management order, the court dismissed the plaintiffs' complaint with prejudice consistent with the procedural rules of the State of New Jersey.^[276] It then noted: "[t]he Court is not willing to continue the instant action with the hope that the defendants eventually will capitulate and give a sum of money to satisfy plaintiffs and their attorneys without having been put to the test of proving their cause of action."^[277]

Other courts have refined and modified the *Lone Pine* order to require plaintiffs to delineate the amount of substance or chemical to which they were exposed or to provide expert medical opinions eliminating other

causes.^[278] Several recent cases also have considered the problem of a plaintiff's failure to provide any proof of causation at a relatively early stage in the litigation process. These have reinforced the concept that a plaintiff should not even file a lawsuit until there is adequate reason to believe that the plaintiff is injured and that the defendant caused that injury.^[279] The same arguments can be made within the insurance context. Relevant areas of inquiry include the following:

1. How does plaintiff's expert know the practice and procedure is not readily acceptable in the insurance industry?
2. Does the plaintiff's expert conform to peer review?
3. Is the testimony of the plaintiff's expert on issues of reconstruction consistent with industry standards and reconstruction principles?
4. Is there a gap between the expert opinion offered and the data or study relied upon?

The use of *Lone Pine* orders has been recognized as useful in achieving judicial efficiencies and economies, regulating complicated evidentiary issues, and avoiding duplication of efforts.^[280] Therefore, when faced with evidentiary and expert issues in this type of litigation, defense counsel should seek a case management order early on in the litigation process. That order also should seek a prima facie showing that any expert evidence satisfies the appropriate standard as articulated in *Daubert*, *Joiner* and *Kumho* or *Frye*.

G. *The Aim*

"Junk science" and the "junk expert" must be challenged early in the litigation process to thwart frivolous and speculative litigation and to preclude testimony of expert witnesses bearing specious credentials. The plaintiffs' bar should be tested and required to provide the defense with evidence concerning the qualifications, reliability and relevance of expert opinions well in advance of trial. Such an approach certainly will control the litigation and settlement costs and is critical to a proactive approach that challenges the "hired gun."

V.

CONCLUSION

If claims handling and negotiation are not considered from the "worst case" perspective, the claims professional and the coverage lawyer will be unable to provide trial counsel with the ammunition to analyze a

bad faith claim after suit. Nor will the claims file provide the necessary evidence to defend the case. Similarly, it will be difficult to challenge the qualifications of an insured's bad faith expert or the admissibility of the expert's testimony at the time of trial. The complete process must be understood at the outset. The claims-handling process begins the continuum necessary to validate a claim; it is not an isolated function that should frustrate the process.

Appendix A

Legislation—New York and California

New York State Bill A02070

This proposed bill adds a new section to New York Insurance Law under the title, § 2601-A—Unfair Claim Settlement Practices: Civil Remedy. The purpose of the bill is to create a private right of action to enable property and casualty insurance policyholders to directly sue insurers for injuries sustained when insurers engage in unfair claims settlement practices. As defined, “not substantially” justified conduct occurs if the insurer:

1. Intentionally, recklessly or by gross negligence failed to provide the policyholder with accurate information concerning policy provisions relating to coverage at issue; or
2. Failed to effectuate, in good faith, a prompt, fair and equitable settlement of a claim submitted by such policyholder in which liability of such insurer to such policyholder was reasonably clear; or
3. Failed to provide a written denial of a policyholder's claim with a full and complete explanation of such denial, including references to specific policy provisions wherever possible; or
4. Failed to make a final determination and notify the policyholder in writing of its position on both the liability for, and the insurer's valuation of, a claim within six months of the date on which it received actual or constructive notice of the loss upon which the claim is based; or
5. Failed to act in good faith by compelling the policyholder to initiate a lawsuit to recover under the policy by offering substantially less than the amounts ultimately recovered in the suit by the policyholder.

Collectible damages include amounts due under the insurance contract, interest, costs and disbursements, compensatory damages, and reasonable attorney fees. Punitive damages are provided if the insurer's actions result from intentional, reckless, grossly negligent conduct, or an express or implied company procedure for

processing claims. Punitive damages are allowed in an amount not more than the total amount received in the action.

The “justification” for the bill provides the following interesting comments:

1. Insurers often engage in one or more unfair settlement practices that can cause substantial financial and sometimes emotional or physical injury to a claimant.
2. Unwarranted delay in payment or requiring the submission of unnecessary or duplicative documentation can cause financial hardship.
3. Citizens should expect insurers to live up to their policy obligations.
4. Under existing law insurers can simply refuse to pay a claim or may offer an amount well below the value of the loss with impunity, with:
 - a) no remedy for unreasonable delay in payment, or
 - b) no remedy for intentional refusal to pay.
5. Insurer has an unfair advantage in negotiating settlement because it can financially bear the cost of litigation.
6. Legislation creates a private right of action to rectify inadequacy of current law.
7. Legislation eliminates the requirement to prove a general business practice.
8. Allowing attorney fees to prevailing claimant promotes enforcement of meritorious claim.
9. Outrageous and unacceptable conduct is addressed by allowing punitive damages in exceptionally aggravated wrongful conduct.
10. Insurers cannot increase premiums to make up for losses, and the losses cannot be included in determining future rates.

Present Legislative History:

01/12/99—referred to insurance committee

02/09/99—reported; referred to codes

02/22/99—reported

02/25/99—advanced to third reading

03/08/99—passed Assembly - 133 yes/12 no

03/08/99—delivered to Senate

01/05/00—died in Senate

01/05/00—returned to Assembly

01/05/00—committed to rules

Past Legislative History (similar bills):

1993—Assembly calendar

1994—Assembly rule

1995—passed Assembly (A. 598-A)

1996—passed Assembly (A. 598-A)

1997—passed Assembly (A. 72)

1998—passed Assembly (A. 72-A)

California - Senate Bill 1237 and Assembly Bill 1309

These two bills, entitled *Fair Insurance Responsibility Act of 2000*, would have changed third-party bad faith in California. However, California voters defeated the bills by a seven to three margin. The insurance lobby contended that the legislation would raise premiums and insurance costs. Critical to the understanding of this bill is an understanding of two cases. In 1979, the California Supreme Court in *Royal Globe Insurance Co. v. Superior Court*,^[281] recognized that third-party claimants could sue insurers for violations of the Unfair Claims Settlement Practices Act.^[282] Subsequently, in 1988, that same court in *Moradi-Shalal v. Fireman's Fund Insurance Cos.*,^[283] overruled *Royal Globe*, holding that actions under the California Unfair Claims Practices statute were not allowed. *Moradi-Shalal* is still the law in California.

If the Fair Insurance Act had been enacted, the legislature would have reinstated the right to sue under *Royal Globe*, but such claims would have been limited to actions based on the “failure to settle” as opposed to the failure to defend. The Act allowed a third party to sue for general, special and exemplary damages when a defendant violated various sections of 790.03 of the Insurance Code, which defines unfair methods of competition and unfair or deceptive acts or practices in the insurance business. Specifically, section 790.03(h) provides that when an insurer knowingly commits or performs enumerated acts with a certain degree of frequency, such activity indicates a general business practice. Note, in comparison, that the proposed New York legislation removes any general business purpose requirement. That section instead references activity such as misrepresenting facts and policy provisions; failing to acknowledge and act reasonably promptly in communicating; failing to implement prompt investigation; failing to attempt good-faith settlement; settlement based on altered application; failing to inform the insured of coverage for payment; delaying the investigation; failing to settle promptly; failing to provide reasonable explanation; directly advising the claimant not to obtain

services of an attorney, and misleading a claimant as to the applicable statute of limitations. The claims professional, however, should review these itemized acts as “cautions” because they are the same acts that could be scrutinized in the future.^[284]

ENDNOTES

^[1] From an educational standpoint, the claims professional and attorney practicing in the extra-contractual/bad faith arena must, on a periodic basis, assess the standards applied in the given jurisdiction and constantly develop benchmarks to gauge the performance of the individual claims office and the company as a whole. The jurisdictions of California, Florida, New York and Texas, because of the diverse standards applied by courts in those states, should be reviewed. Equally important is the responsibility of the claims professional and the practitioner to remain abreast of new legislation and proposed legislative changes. Again, the legislative history behind any enacted or proposed legislation can assist the insurance industry in formulating claims-handling procedures and guidelines. For example, the recent legislative and voter experience in the state of California and proposed legislation in the state of New York highlight the need to be educated; they should alert the industry and its counsel to the ever-changing bad faith atmosphere. (See Appendix A.)

^[2] For an excellent overall discussion of education and prevention, see DENNIS J. WALL, LITIGATION AND PREVENTION OF INSURER BAD FAITH (2d ed. Supp. 1994 & 1995).

^[3] For a general discussion of this issue within the first-party context, see D.G. Houser, *Good Faith: The Insurance Company's Right To Be Wrong*, INT'L INS. MONITOR, May/June, 1994.

^[4] 712 So. 2d 389 (Fla. 1998).

^[5] *Id.* at 393. For an excellent discussion of the insurer's rights in this area, see J.M. White, *Suspicious Claims*, presented at the DRI First-Party Property Seminar, Tampa, Florida, Feb. 2000; *see generally*, Gulf Atl. Life Ins. Co. v. Barnes, 405 So. 2d 916 (Ala. 1981); Noble v. Nat'l Amer. Life Ins. Co., 624 P.2d 866 (Ariz. 1981); Dolan v. Aid Ins., 431 N.W.2d 790 (Iowa 1988); Bibeault v. Hanover Ins. Co., 417 A.2d 313 (R.I. 1980); Wright v. League Gen. Ins. Co., 421 N.W.2d 647 (Mich. 1988) and Gibson v. Group Ins. Co., 369 N.W.2d 484 (Mich. 1985).

[\[6\]](#) See *St. Paul Surplus Lines Ins. Co. v. Dal-Worth Tank Co.*, 917 S.W.2d 29 (Tex. Ct. App. 1995).

[\[7\]](#) See *Allen v. Allstate Ins. Co.*, 656 F.2d 487 (9th Cir. 1981).

[\[8\]](#) 285 N.E.2d 849 (N.Y. 1972).

[\[9\]](#) *Id.* at 852.

[\[10\]](#) 424 F.2d 728 (5th Cir. 1970).

[\[11\]](#) *Id.* at 734. For an excellent discussion of the advice of defense counsel, see WILLIAM H. SHERNOFF ET AL., *INSURANCE BAD FAITH LITIGATION* § 30.04 (1999) and STEPHEN S. ASHLEY, *BAD FAITH ACTIONS—LIABILITY & DAMAGES* § 7:13 (1997); see also Annotation, *Reliance On, or Rejection of, Advice of Counsel as Factor Affecting Liability in Action Against Liability Insurer for Wrongful Refusal to Settle Claim*, 63 A.L.R.3d 725 (1975).

[\[12\]](#) See Kevin M. Christensen, *Take My Advice: How Listening to Your Lawyer Might Limit Your Liability*, MEALEY'S LITIG. REP.: INS. BAD FAITH, Nov. 7, 2000, at 22.

[\[13\]](#) See also Lee Craig, *Ten Stupid Things Insurance Companies Do To Mess Up Their Files*, MEALEY'S LITIG. REP.: INS. BAD FAITH, Nov. 21, 2000, at 31.

[\[14\]](#) See generally Thomas E. Workman, *Plaintiff's Right to the Claim File, Other Claim Files and Related Information: The Ticket to the Gold Mine*, 24 TORTS & INS. L.J. 137, 155 (1988); John J. Pappas, *Institutional Bad Faith Claims*, presented at the DRI Extra-Contractual Liability Seminar, Atlanta, Georgia, Sept. 1998; P.M. Kaplan, *Discoverability of Claim Files in Bad Faith Litigation*, FOR THE DEFENSE, 9, Feb., 1991.

[\[15\]](#) The foregoing lapses in judgment were enumerated by Atty. Brad Crawford of Crawford, Hyde & Associates, Dallas, Texas. They were provided during his presentation at the 1999 Annual Seminar of the International Association of Special Investigative Units, Dallas, Texas, September, 1999; see also Dennis J. Wall, *Avoiding "Bad Faith" in Settlement: What are the Developments?*, 63 DEF. COUN. J. 249 (1996).

[\[16\]](#) See *Employees' Benefit Ass'n v. Grissett*, 732 So. 2d 968 (Ala. 1998); *State Farm Fire & Cas. Co. v. Slade*, 747 So. 2d 293 (Ala. 1999); *Alfa Mut. Fire Ins. Co. v. Thomas*, 738 So. 2d 815 (Ala. 1999).

[\[17\]](#) M. Elizabeth Medaglia et al., *Privilege, Work Product, and Discovery Issues in Bad Faith Litigation*, 32 TORT & INS. L.J. 1 (1996).

[\[18\]](#) See *Maxwell v. Fire Ins. Exchange*, 70 Cal. Rptr. 2d 866 (Ct. App. 1998) (allowing recovery in both third- and first-party claims). For a general and thorough discussion of the availability of emotional distress

damages, *see* Wall, *supra* note 2, at § 13.08; *see also* David R. Anderson & John W. Dunfee, *No Harm, No Foul: Why A Bad Faith Claim should Fail When an Insurer Pays the Excess Verdict*, 33 TORT & INS. L.J. 1001, 1006-08 (1998).

[\[19\]](#) *See generally* DENNIS. J. WALL, LITIGATION AND PREVENTION OF INSURER BAD FAITH §§ 9.23, 9.24 (2d ed. 1994).

[\[20\]](#) *See generally id.* §§ 3.96, 3.97 and 3.98.

[\[21\]](#) For an extremely practical analysis of the communication issue, *see* Janet K. Colaneri & Bobbi Reilly, *Bad Faith: What Is It? Is It Catching? How Do I Avoid It*, presented at International Association of Special Investigative Units, Dallas, Tex., September, 1999.

[\[22\]](#) *Brown v. Superior Court*, 670 P.2d 725, 734 (Ariz. 1983).

[\[23\]](#) *Id.* at 734.

[\[24\]](#) *Meritplan Ins. Co. v. Superior Court*, 177 Cal. Rptr. 236, 238 (Ct. App. 1981).

[\[25\]](#) *See* Craig, *supra* note 13, at 31.

[\[26\]](#) Arnold D'Angelo, Jr., *Modern Trends In First-Party Insurance Litigation*, presented at the DRI First-Party Property Seminar, Tampa, Fla., Feb. 2000; *see also* Pappas, *supra* note 14, which characterizes this type of bad faith litigation as "Institutional Bad Faith."

[\[27\]](#) Pappas, *supra* note 14, at C-8.

[\[28\]](#) Materials taken from speech delivered by Arnold D'Angelo, Jr., at DRI First-Party Property Seminar, *supra* note 26.

[\[29\]](#) D'Angelo, *supra* note 26, at 15.

[\[30\]](#) *See* Janet L. Brown & Amanda H. Reher, *Personal Liability of Adjusters and Other Claims Professionals*, presented at DRI First-Party Property Seminar, Tampa, Fla., Feb., 2000.

[\[31\]](#) *See* Pappas, *supra* note 14, at C-22-23 (listing twenty-five categories of documents whose production was demanded in a particular case).

[\[32\]](#) *See* Jonathan Gross, *Defending "Pattern and Practice" Evidence in Punitive Damage Cases*, 61 DEF. COUN. J. 403 (1994); D'Angelo, *supra* note 26, at 7.

[\[33\]](#) *See* Roberto Cenicerros, *Making a Case for Coverage: Policyholder Tries to Bolster Bad Faith Charge Against Insurer*, BUSINESS INSURANCE, Oct. 25, 1999 at 2.

[34] D'Angelo, *supra* note 26, at 19. This appears to be a more realistic approach to the business environment and judicial atmosphere presently confronted by the insurance industry.

[35] For an excellent discussion of the bad faith setup, see Stephen R. Schmidt, *The Bad Faith Setup*, 29 TORT & INS. L. J. 705 (1994). *See also* Robert T. Horst & Robert M. Runyon, III, *How To Diagnose and Avoid the Bad Faith 'Set Up' in the First-Party Property Insurance Context*, 14 MEALEY'S LITIG. REP.: INS. BAD FAITH, Dec. 5, 2000.

[36] Schmidt, *supra* note 35, at 705.

[37] *See* Patrick v. State Farm Mut. Auto. Ins. Co., 919 F.2d 906 (5th Cir. 1990); Baton v. Transamerica Ins. Co., 584 F.2d 907 (9th Cir. 1978); DeLaune v. Liberty Mut. Ins. Co., 314 So. 2d 601 (Fla. Dist. Ct. App. 1975); Pavia v. State Farm Mut. Auto. Ins. Co., 589 N.Y.S.2d 510 (App. Div. 1992), *rev'd*, 626 N.E.2d 24 (N.Y. 1993). *See also* Schmidt, *supra* note 35, at 712.

[38] *DeLaune*, 314 So. 2d at 604.

[39] Schmidt, *supra* note 35, at 728.

[40] AMERICAN HERITAGE DESK DICTIONARY 1030 (1981).

[41] *See* the 1999 Report to the Governor and the Legislature of the State of New York on the operations of the Insurance Frauds Prevention Act (article 4 of Insurance Law), at <http://www.ins.state.ny.us/p0002091.htm>. The number of criminal convictions in insurance fraud cases almost doubled in 1999 as compared to 1998.

[42] Schmidt, *supra* note 35; Thomas F. Segalla, *Bad Faith Avoidance: Who Sets the Trap?*, presented at the Defense Research Institute Extra-Contractual Seminar, 2000.

[43] Examples of recent headline verdicts (without insurers identified) include:

- Insurer Ordered To Pay \$30 Million For Lying About Pollution Exclusion
- Insurer That Denies Long-Term Care Coverage Hit With \$2 Million Verdict
- Insurer Hit For Frivolous Liability Defense

[44] *Commercial Union Assur. Co. v. Safeway Shoes, Inc.*, 610 P.2d 1038 (Cal. 1980); *see also* *Rawlings v. Apodaca*, 726 P.2d 565 (Ariz. 1986); *Beck v. Farmers Ins. Exch.*, 701 P.2d 795 (Utah 1985); *Modisette v. Found. Reserve Ins. Co.*, 427 P.2d 21 (N.M.1967); *see generally* F. Krinick, *Comparative Bad Faith: A New Defense? New York Courts Have Not Yet Been Asked to Accept the Doctrine*, N.Y. LAW J. (1/12/98), available at <http://www.rivkinradler.com/nylj198.html> (last updated 9/28/00).

- [\[45\]](#) Texas Farmers Ins. Co. v. Soriano, 844 S.W.2d 808, 832 n.2 (Tex. Ct. App. 1992).
- [\[46\]](#) Express Textile v. General Accid., Inc., No. 98-CV-5056 CBM, C.D.Cal., reported in 13(24) MEALEY'S LITIG.REP.: INSURANCE BAD FAITH 10 (4/18/00); L.A. TIMES, Apr. 18, 2000, at B6 (valley ed., metro).
- [\[47\]](#) Allstate Ins. Co. v. Booth, No. 98-CV-503 (C.D. Cal. June 10, 1998).
- [\[48\]](#) Provident Life v. O'Connor, No. 96-56015 (9th Cir. Nov. 5, 1997).
- [\[49\]](#) See generally DENNIS J. WALL, LITIGATION AND PREVENTION OF INSURER BAD FAITH (2d ed. 1994).
- [\[50\]](#) Zurich Re (North American) & F.A. Smith, *Bad Faith: A Fifty State Survey*, available at <http://www.sdma.com/images/BadFaithFiftyStateSurvey.html> (last updated 9/28/00).
- [\[51\]](#) Neal v. Farmers Ins. Exch., 582 P.2d 980 (Cal. 1979). For a general discussion of California law, see BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES §§ 12.02, 12.03(a) (10th ed. 2000).
- [\[52\]](#) Pavia v. State Farm Mut. Auto. Ins. Co., 626 N.E.2d 24, 27-28 (N.Y. 1993) (gross disregard standard applied in third-party context); New York Univ. v. Continental Ins. Co., 662 N.E.2d 763, 767 (N.Y. 1995) (applying an egregious conduct standard directed at public in general). For a general discussion of New York law, see OSTRAGER & NEWMAN, *supra* note 51, §§12.04, 12.12(a).
- [\[53\]](#) Hawkins v. Allstate Ins. Co., 733 P.2d 1073 (Ariz. 1987), *rev'd on other grounds*, 30 F.3d 1077 (9th Cir. 1994), *cert. denied*, 515 U.S. 1141 (1995).
- [\[54\]](#) For a fifty-state survey on bad faith law, see Re & Smith, *supra* note 50, which provides an appendix setting forth a state-by-state analysis of first-party and third-party bad faith law; see also OSTRAGER & NEWMAN, *supra* note 51, at § 12.12(b), which provides a survey of first-party bad faith cases in various jurisdictions.
- [\[55\]](#) STEPHEN S. ASHLEY, BAD FAITH LIABILITY: A STATE BY STATE REVIEW § 4:02 (1987); William S. Anderson, Comment, *Placing A Check on an Insured's Bad Faith Conduct; The Defense of "Comparative Bad Faith,"* 35 S. TEX. L.REV. 485, 489 (1994); Douglas R. Richmond, *An Overview of Insurance Bad Faith Law and Litigation*, 25 SETON HALL L. REV. 74, 80-81 n.33 (1994).
- [\[56\]](#) 2 P.3d 1 (Cal. 2000).

[57] *Id.* at 8 (citations omitted).

[58] *Id.* at 19-26.

[59] *Id.* at 8 (citing *Murphy v. Allstate Ins. Co.*, 553 P.2d 584 (Cal. 1976)).

[60] *Lawton v. Great Southwest Fire Ins. Co.*, 392 A.2d 576, 579 (N.H. 1978).

[61] *Strause v. Farmers Ins. Exch.*, 31 Cal. Rptr. 811, 813-14 (Ct. App. 1994); *Med. Mut. Liab. Ins. Soc. v. Evans*, 622 A.2d 103, 114 (Md. 1993); *Soto v. State Farm Ins. Co.*, 635 N.E.2d 1222 (N.Y. 1999).

[62] *See generally* OSTRAGER & NEWMAN, *supra* note 51, § 12.12.

[63] *Id.*

[64] For a general discussion of the test applied in first-party cases, *see* Douglas R. Richmond, *The Two-Way Street of Insurance Good Faith: Under Construction, But Not Yet Open*, 28 LOY. U. CHI. L.J. 95 (1996). It should be noted that Justice Kennard cited this article in his dissenting opinion in *Kransco*. *See Kransco*, 2 P.3d at 418.

[65] *See generally* William M. Savino, *Comparative and Reverse Bad Faith: The Covenant is Reciprocal*, 7(1) MEALEY'S LITIG. REP.: INS. (5/6/93); Anderson, *supra* note 55, at 505; J. Lee Boothby, *Comparative Bad Faith: Will the Courts Allow Insurance Carriers to Introduce a Unicorn into Insurance Bad Faith Litigation?*, 18 T. JEFFERSON L. REV. 121 (1996).

[66] Anderson, *supra* note 55, at 507 (citing *Fleming v. Safeco Ins. Co. of Am.*, 206 Cal. Rptr. 313 (Ct. App. 1984) and *California Cas. Gen'l Ins. Co. v. Superior Court*, 218 Cal. Rptr. 817, 818 (Ct. App. 1985)).

[67] *See generally* Ellen Smith Pryor, *Comparative Fault and Insurance Bad Faith*, 72 TEX. L. REV. 1505 (1994); Douglas G. Houser et al., *Comparative Bad Faith: The Two-Way Street Opens for Travel*, 23 IDAHO L. REV. 367, 377 (1986-87); Patrick E. Shipstead & Scott S. Thomas, *Comparative and Reverse Bad Faith: Insured's Breach of Implied Covenant of Good Faith and Fair Dealing as Affirmative Defense or Counterclaim*, 23 TORT & INS. L.J. 215, 231 (1987).

[68] *Kransco*, 2 P.3d at 13.

[69] For a general discussion of contract defenses, *see* Pryor, *supra* note 67, at 1522-25.

[70] *Blake v. Aetna Life Ins. Co.*, 160 Cal. Rptr. 528, 538 (Ct. App. 1979); *Campbell v. Allstate Ins. Co.*, 32 Cal. Rptr. 827, 829 (Ct. App. 1963).

- [711] Dyno-Bite, Inc. v. Travelers Cos., 439 N.Y.S.2d 558, 560 (App. Div. 1981). *See also* OSTRAGER & NEWMAN, *supra* note 51, §§ 2:08(a) and (b).
- [721] Imperial Cas. & Indemn. Co. v. Sogomonian, 243 Cal. Rptr. 639, 646 (Ct. App. 1988); OSTRAGER & NEWMAN, *supra* note 51, § 3.01.
- [731] Agricultural Ins. Co. v. Superior Court, 82 Cal. Rptr. 2d 594 (Ct. App. 1999).
- [741] 78 F. Supp. 2d 436 (D.V.I. 1999). The following jurisdictions have rejected the defense of comparative bad faith: Nationwide Prop. & Cas. Ins. Co. v. King, 568 So. 2d 990 (Fla. Dist. Ct. App. 1990); Kelly v. State Farm Mut. Auto Ins. Co., 764 F. Supp. 1337 (S.D. Iowa 1991); Stephen v. Safeco Ins. Co. of Am., 852 P.2d 565 (Mont. 1993); Stumpf v. Continental Cas. Co., 794 P.2d 1228 (Or. Ct. App. 1990); Isaac v. State Farm Mut. Auto. Ins. Co., 522 N.W.2d 752 (S.D. 1994); Powers v. United Serv. Auto Ass'n., 962 P. 596 (Nev. 1998).
- [751] *In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d at 455.
- [761] State Farm Fire & Cas. Co. v. Gandy, 880 S.W.2d 129 (Tex. Ct. App. 1994), *rev'd on other grounds*, 925 S.W.2d 691 (Tex. 1996) (trial court should have submitted comparative bad faith to the jury); Dalton v. Educ. Testing Serv., 663 N.E.2d 289 (N.Y. 1995) (obligations are imposed on both insurer and insured); Rawlings v. Apodaca, 726 P.2d 565 (Ariz. 1986); Modisette v. Found. Reserve Ins. Co., 427 P.2d 21 (N.M. 1967); Commercial Union Assur. Co. v. Safeway Stores, Inc., 610 P.2d 1038 (Cal. 1980) (two-way street running from the insured to his insurer and vice versa); Ins. Co. of N. Am. v. Milberg Weiss Bershad Specthrie & Lerach, No. 95 Civ. 3722 (LLS) (S.D.N.Y. 1996) (allowing an affirmative defense of comparative bad faith); Carpenter v. Auto. Club Interins Exch., 58 F.3d 1296, 1303-04 (8th Cir. 1995) (applying Arkansas law, court allowed defenses of contributory negligence and lack of good faith). Specifically, the court rejected the Texas decision in State Farm Fire & Cas. Co. v. Gandy, 880 S.W.2d 129 (Tex. Ct. App. 1994), *rev'd on other grounds*, 925 S.W.2d 691 (Tex. 1996) (court held that comparative bad faith created a jury question).
- [771] No. L-2322-96 (N.J. Super. Ct., Somerset Co., July 14, 2000).
- [781] *Id.*; *but see* Willis Corroon Corp. v. Home Ins. Co., 203 F.3d 449, 453 (7th Cir. 2000) (court refused to allow amendment to include claim for reverse bad faith because there was no evidence; court observed that it was highly doubtful such a claim existed).
- [791] Evan H. Krinick, *Comparative Bad Faith: A New Defense? New York Courts Have Not Yet Been Asked to Accept the Doctrine*, N.Y. L.J. (1/12/98), available at <http://www.rivkinradler.com/nylj198.html> (last updated 9/28/00).

[\[80\]](#) R. Kent Livesay, *Levelling the Playing Field of Insurance Agreements in Texas: Adopting Comparative Bad Faith as an Affirmative Defense Based on the Insured's Misconduct*, 24 TEX. TECH L. REV. 1201, 1213 (1993).

[\[81\]](#) Samuel H. Ruby, *The Demise of Comparative Bad Faith: The California Supreme Court Strikes Tort Defenses to Insurers' Tort Liability*, MEALEY'S LITIG. REP.: INS. BAD FAITH, Sept. 5, 2000, at 26.

[\[82\]](#) Tex. Farmers Ins. Co. v. Soriano, 844 S.W.2d 808, 832 n.2 (Tex. Ct. App. 1992).

[\[83\]](#) Kransco v. American Empire Surplus Lines Ins. Co., 2 P.3d 1, 17 (Cal. 2000).

[\[84\]](#) *Id.* at 11 (emphasis added.)

[\[85\]](#) *Id.*

[\[86\]](#) Boothby, *supra* note 65, at 126-27 (discussing the cases of *Safeco Ins. Co. of Amer. v. Tholen*, 173 Cal. Rptr. 23 (Ct. App. 1981) and *Comunale v. Traders & Gen'l. Ins. Co.*, 328 P.2d 198 (Cal. 1958) (citations omitted)).

[\[87\]](#) *See generally* Livesay, *supra* note 80; *see also* Arnold v. Nat'l Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987).

[\[88\]](#) ASHLEY, *supra* note 55, at § 214; Livesay, *supra* note 80, at 1215.

[\[89\]](#) *Id.*; Lawrence P. McLellan, Note, *Insurance Settlements: An Insured's Bad Faith*, 31 DRAKE L. REV. 877, 880 (1981).

[\[90\]](#) Livesay, *supra* note 80, at 1226.

[\[91\]](#) For a general discussion of bad faith law in Texas and outlining reasons for such a defense, *see* Livesay, *supra* note 80.

[\[92\]](#) *See, e.g.*, N.Y. C.P.L.R., art. 14 (2000) or TEX. CIV. PRAC. & REM. CODE ANN. § 33.001 (2000).

[\[93\]](#) Livesay, *supra* note 80, at 1212-13.

[\[94\]](#) *Id.* at 1219-20.

[\[95\]](#) For a discussion of how to plead a comparative bad faith defense, *see* Livesay, *supra* note 80, at 1224-25 (reviewing the pleading rules of the State of Texas).

[\[96\]](#) Richmond, *supra* note 55, at 134.

[\[97\]](#) First Bank of Turley v. Fid. & Deposit Ins. Co., 928 P.2d 298, 307 (Okla. 1996).

- [\[98\]](#) *In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d 436 (D.V.I. 1999); for a general discussion of reverse bad faith, *see* OSTRAGER & NEWMAN, *supra* note 51, § 12.13.
- [\[99\]](#) OSTRAGER & NEWMAN, *supra* note 51, § 12.13.
- [\[100\]](#) *Id.*
- [\[101\]](#) Lori J. Caldwell & David B. Shelton, *Faced With a Bad Faith Suit? A Reverse Bad Faith Claim may be an Alternative*, available at http://www.rumberger.com/art_fraud.htm (last updated 10/17/00).
- [\[102\]](#) Richmond, *supra* note 55, at 128.
- [\[103\]](#) 78 F. Supp. 2d 436 (D.V.I. 1999).
- [\[104\]](#) *Id.* at 441.
- [\[105\]](#) *Id.* at 443. Concluding that no common law cause of action for reverse bad faith existed, the court had to disregard its prior ruling in this case in which it had determined that the insured acted in bad faith concerning a settlement agreement. *Id.*
- [\[106\]](#) 605 N.E.2d 939, 945 (Ohio 1992).
- [\[107\]](#) 928 P.2d 298 (Okla. 1996).
- [\[108\]](#) 533 N.W.2d 203 (Iowa 1995).
- [\[109\]](#) *In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d at 453 (D.V.I. 1999) (citing the insurer's (Cigna) brief at 23).
- [\[110\]](#) For a general discussion of those jurisdictions that have applied the doctrine of reverse bad faith, *see* Cathryn M. Little, *Fighting Fire with Fire: "Reverse Bad Faith" in First-Party Litigation Involving Arson and Insurance Fraud*, 19 CAMPBELL L.REV. 43, 44 (1996).
- [\[111\]](#) 928 P.2d 298, 308 (Okla. 1996).
- [\[112\]](#) 664 N.E.2d 858 (Mass. App. Ct. 1996).
- [\[113\]](#) *Id.*
- [\[114\]](#) 502 N.W.2d 282 (Wis. Ct. App. 1993).
- [\[115\]](#) No. 95-0019, 1996 U.S. Dist. LEXIS 5782 (E.D. Pa. April 29, 1996).
- [\[116\]](#) 423 N.W.2d 712, 714 (Minn. Ct. App. 1988).

- [\[117\]](#) TENN. CODE ANN. § 56-7-106 (2000); *Adams v. Tenn. Farmers Mut. Ins. Co.*, 898 S.W.2d 216, 219-20 (Tenn. Ct. App. 1994).
- [\[118\]](#) For a discussion of these unreported decisions from the states of Texas and Connecticut and the recommended position in North Carolina, *see* Little, *supra* note 110, at 52–54.
- [\[119\]](#) *See* Richmond, *supra* note 55; Anderson, *supra* note 55; Shipstead & Thomas, *supra* note 67; John F. Dobbyn, *Is Good Faith in Insurance Contracts a Two-Way Street?* 62 N.D. L. REV. 355, 370-77 (1986).
- [\[120\]](#) Richmond, *supra* note 55, at 136-37.
- [\[121\]](#) *Id.* at 139 (citations omitted).
- [\[122\]](#) Little, *supra* note 110, at 47-49.
- [\[123\]](#) *Id.* at 47.
- [\[124\]](#) Richmond, *supra* note 55, at 139.
- [\[125\]](#) *See* Lee Craig, *Malicious Defense*, 13 MEALEY’S LITIG.REP. No. 16 at 25 (12/21/99) (concluding that such a tort action is not needed in suits against insurance companies). *See also* Jonathan K. Van Patten & Robert E. Willard, *The Limits of Advocacy: A Proposal for the Tort of Malicious Defense in Civil Litigation*, 35 HASTINGS L.J. 891 (July, 1984).
- [\[126\]](#) *See* Triplett v. Farmers Ins. Exch., 29 Cal. Rptr. 2d 741 (Ct. App. 1994); *cf.* Aranson v. Schroeder, 671 A.2d 1012 (N.H. 1995).
- [\[127\]](#) 533 N.W.2d 203 (Iowa 1995).
- [\[128\]](#) *Id.* at 209.
- [\[129\]](#) *Id.*
- [\[130\]](#) *Id.*
- [\[131\]](#) *Id.*
- [\[132\]](#) Craig, *supra* note 125, at 26.
- [\[133\]](#) 671 A.2d 1023 (N.H. 1995).
- [\[134\]](#) *Id.* at 1029.
- [\[135\]](#) 95 Cal. Rptr. 2d 583 (Ct. App. 2000).
- [\[136\]](#) *Id.* at 688 n.5.

- [137] Craig, *supra* note 125, at 20.
- [138] 533 N.W.2d 203 (Iowa 1995).
- [139] For examples, see the following state statutes: FLA. STAT. Ch. 57.105 (2000); IOWA R. CIV. P. 80(a) (2000); N.Y. C.P.L.R. 8303-a (McKinney 2000); N.C. R. CIV. P. § 1A1, Rule 11 (2000).
- [140] Little, *supra* note 110, at 63-64.
- [141] No. 1CV 97-1405 (M.D. Pa. 2000) (reported in 14 MEALEY'S LITIG. REP. 8 at G-1).
- [142] *Id.*
- [143] Case No. 93-CV-2123, consolidated with case no. 94-CV-1692 (4/25/00 #574), S.D. Fla., Civil Docket; *see also* Craig, *supra* note 125, at 28.
- [144] Shaun McParland Baldwin & Lisa C. Breen, *Malpractice Claims by Primary and Excess Insurers: Is the Honeymoon Over?*, 62 DEF. COUNS. J. 18, 18 (1995); *see also* Robert D. Allen, *Insurers Suing Defense Counsel*, at 335 (presented at the DRI Insurance Coverage and Practice Seminar, 2000).
- [145] 2 P.3d 663 (Ariz. Ct. App. 1999).
- [146] Charles Silver & Kent Syverud, *The Professional Responsibilities of Insurance Defense Lawyers*, 45 DUKE L. J. 255, 280 (1995).
- [147] *Paradigm*, 2 P.3d at 669-70; *see also* Home Indem. Co. v. Lane, Powell, Moss & Miller, 43 F.3d 1322 (9th Cir. 1995) (an attorney-client relationship exists where there is no conflict); Unigard Ins. Group v. O'Flaherty & Belgum, 48 Cal. Rptr. 2d 565 (Ct. App. 1995) (permitting a direct action by an insurer against defense counsel); Smiley v. Manchester Ins. & Indemn. Co., 375 N.E.2d 118 (Ill. 1978) (an insurer can sue defense counsel when liability is firmly established); *see generally* Michael J. Brady, *Defense Counsel's Liability to Insurer for Excess Liability*, 49 FED'N INS. & CORP. COUNS. Q. 55, 59-60 (1998).
- [148] 93 Cal. Rptr. 2d 534 (Ct. App. 2000).
- [149] 210 Cal. Rptr. 578 (Ct. App. 1985).
- [150] *Id.* at 609.
- [151] *See* Allen, *supra* note 144, at 341.
- [152] 985 S.W.2d 166 (Tex. Ct. App. 1998).
- [153] 980 S.W.2d 625 (Tex. 1998).

[\[154\]](#) For an excellent analysis of these alternate theories, *see* Allen, *supra* note 144, at 341–46.

[\[155\]](#) *Am. Centennial Ins. Co. v. Canal Ins. Co.*, 843 S.W.2d 480, 483 (Tex. 1992). *But see* *Cont'l Cas. Co. v. Pullman, Conley*, 929 F.2d 103 (2d Cir. 1991), *aff'g* 709 F. Supp. 44 (D. Conn. 1989); *see also* Allen, *supra* note 144, at 342-44 for a discussion of the various jurisdictions.

[\[156\]](#) *Pullman, Conley*, 929 F.2d at 103; *Zumga v. Groce, Locke & Hebdon*, 878 S.W.2d 313, 315 (Tex. Ct. App. 1994). *But see* the analysis of Texas law in Allen, *supra* note 144, at 346, where he concludes that Texas is “ripe for change.”

[\[157\]](#) *Pullman, Conley*, 929 F.2d at 105 (recognizing a “chilling effect of the third-party intrusion”). *See also* Allen, *supra* note 144, at 346.

[\[158\]](#) This paper does not consider the subrogation rights of an insurer against third parties for benefits paid by the insurer to its insured. For a general discussion of subrogation, *see* OSTRAGER & NEWMAN, *supra* note 51, § 5.06[d].

[\[159\]](#) *See generally* LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE 3D § 226 (2000) [hereinafter COUCH ON INSURANCE].

[\[160\]](#) *Mahler v. Szucs*, 957 P.2d 632 (Wash. 1998) (the term “reimbursement” involves a situation where the insurer can “recoup” its payment from the proceeds paid to the insured by the third-party tortfeasor).

[\[161\]](#) *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997) (an insurer may seek reimbursement from the insured for costs of defending the insured in a case where there are covered and noncovered claims based on an apportionment theory; however, reimbursement is only allowed for costs related to claims that are not even potentially covered). For an updated discussion of the reimbursement of defense cost issues, *see* Robert H. Jerry, II, *The Insurer's Right to Reimbursement of Defense Costs*, 42 ARIZ. L. REV. 13 (2000); *see generally* COUCH ON INSURANCE, *supra* note 159, § 226:43.

[\[162\]](#) *Id.*, 939 P.2d 766.

[\[163\]](#) *Hartford Acc. & Indemn. Co. v. Chicago Hous. Auth.*, 12 F.3d 42 (7th Cir. 1993); *Cohn v. Anthem Life & Health Ins. Co.*, 965 F. Supp. 1119 (N.D. Ill. 1997); *see generally* OSTRAGER & NEWMAN, *supra* note 51, § 5.07.

[\[164\]](#) A complete discussion of an insurer's action for fraud is beyond the scope of this article. *See generally* COUCH ON INSURANCE, *supra* note 159, § 226:89 (citing the general rule that where an insurer pays benefits

in justifiable ignorance of the fact that insurance was procured by false representation, it is entitled to a return of the money).

[165] For a discussion of the cost/benefit of reimbursement of defense costs, *see* Jerry, *supra* note 161, at 74-75.

[166] *Id.* at 75.

[167] 95 Cal. Rptr. 2d 583 (Ct. App. 2000).

[168] 939 P.2d 766 (Cal. 1997).

[169] 95 Cal. Rptr. 2d at 595.

[170] *Id.* *But see* Nationwide Mut. Fire Ins. Co. v. John P. Masseria, NQ. 98-G 2197, Ohio App., 11th Dist. (12/7/00) (where court allowed an insured's bad faith claim because insurer failed to investigate before instituting a declaratory judgment action).

[171] *See id.* at 599 and n.5 for a discussion of the standards applicable to a malicious prosecution claim in California.

[172] 509 U.S. 579 (1993).

[173] 522 U.S. 136 (1997).

[174] 526 U.S. 137 (1999).

[175] 293 F. 1013 (D.C. Cir. 1923).

[176] PETER W. HUBER, GALILEO'S REVENGE: JUNK SCIENCE IN THE COURTROOM (1991); *see also* Erica Beecher-Monas, *Blinded by Science: How Judges Avoid the Science in Scientific Evidence*, 71 TEMP. L. REV. 55 (1998). For an excellent discussion of the *Daubert* progeny, *see* Neil E. Mathews & Leondra M. Hanson, *Daubert After Kumho Tire; How the Gatekeeper Evaluates the "Non-Scientific Expert,"* DRI Business Litigation Seminar 131 (1999); Scott R. Jennette, *Attacking the Plaintiff's Hazardous Substance Expert in the Post-Kumho Era*, 41 FOR THE DEFENSE 33 (May 1999); Jonathan M. Hoffman & Bert Black, *Old Tires and New Limbs: The Effect of Kumho Tire on Expert Testimony*, 27 PROD. SAFETY & LIAB. REP. (BNA) 354 (Apr. 2, 1999).

[177] 509 U.S. 579 (1993).

[178] 293 F. 1013 (D.C. Cir. 1923).

[179] *Daubert*, 509 U.S. at 588.

[\[180\]](#) *Id.* at 588.

[\[181\]](#) *Id.* at 590.

[\[182\]](#) *Id.* at 593-94.

[\[183\]](#) *Id.* at 592.

[\[184\]](#) *Id.* at 600.

[\[185\]](#) See generally Bert Black et al., *The Law of Expert Testimony — A Post-Daubert Analysis in Expert Evidence*, in A PRACTITIONER'S GUIDE TO LAW, SCIENCE AND THE FJC MANUAL 9, 47 (B. Black & P.W. Lee eds. 1997).

[\[186\]](#) See discussion in section B.1.b., *infra*.

[\[187\]](#) *Daubert v. Merrell Dow Pharm., Inc.*, 43 F.3d 1311 (9th Cir. 1995).

[\[188\]](#) 522 U.S. 136 (1997).

[\[189\]](#) For a discussion of which circuits applied the abuse of discretion standard of review or the de novo standard, see *United States v. Jones*, 107 F.3d 1147 (6th Cir. 1997), *cert. denied*, 521 U.S.1127 (1997).

[\[190\]](#) *Joiner*, 522 U.S. at 137.

[\[191\]](#) *Id.* at 146.

[\[192\]](#) For a discussion of the standard adopted by the various states, see *Mathews & Hanson*, *supra* note 176, at 150.

[\[193\]](#) See *Iacobelli Const. v. County of Monroe*, 32 F.3d 19 (2d Cir. 1994); *Tamarin v. Adam Caterers, Inc.*, 13 F.3d 51 (2d Cir. 1993); *McKendall v. Crown Control Corp.*, 122 F.3d 803 (9th Cir. 1997); *Compton v. Subaru of Am.*, 82 F.3d 1513 (10th Cir. 1996), *cert. denied*, 519 U.S. 1042 (1996). The First, Fourth and Eleventh Circuits allowed district judges to review nonscientific expert evidence, but held that they could not utilize the *Daubert* factors. See *Bogosian v. Mercedes-Benz of N. Am., Inc.* 104 F.3d 472 (1st Cir. 1997); *Michigan Millers Mut. Ins. Co. v. Benfield*, 140 F.3d 915 (11th Cir. 1998).

[\[194\]](#) See *Watkins v. Telsmith, Inc.*, 121 F.3d 984 (5th Cir. 1997); *Smelser v. Norfolk S. Ry.*, 105 F.3d 299 (6th Cir. 1997), *cert. denied*, 522 U.S. 817 (1997); *Deimer v. Cincinnati Sub-Zero Prod.*, 58 F.3d 341 (7th Cir. 1995); *Cummins v. Lyle Indus.*, 93 F.3d 362 (7th Cir. 1996); *Peitzmeier v. Hennessy Indus.*, 97 F.3d 293 (8th Cir. 1996), *cert. denied*, 520 U.S. 1196 (1997). For a discussion of the conflict among the circuits, see *Hoffman & Black*, *supra* note 176, at 356-59.

- [195] 526 U.S. 137 (1999).
- [196] Carmichael v. Samyang Tires, Inc., 923 F. Supp. 1514, 1521-22 (S.D. Ala. 1996), *rev'd.*, 131 F.3d 1433 (11th Cir. 1997).
- [197] *Kumho*, 526 U.S. at 152.
- [198] *Id.*
- [199] 173 F.3d 1076 (8th Cir. 1999).
- [200] *Jaurequi*, 173 F.2d at 1084; *see also* Peitzmeier v. Hennessy Indus., Inc., 97 F.3d 293 (8th Cir. 1996), *cert. denied*, 520 U.S. 1196 (1997).
- [201] 151 F.3d 269 (5th Cir. 1998), *cert. denied*, 526 U.S. 1064 (1999).
- [202] 728 A.2d 70 (D.C. 1999).
- [203] *Id.* at 75.
- [204] 293 F. 1013 (D.C. Cir. 1923).
- [205] *Id.* at 1014.
- [206] *See* Castrichini v. Rivera, 669 N.Y.S.2d 140 (Sup. Ct. 1997).
- [207] *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).
- [208] For a recent discussion of the applicability of the *Daubert* standards to the insurance industry, see Walter J. Andrews, *Insurance 'Experts' and the Daubert Doctrine after Kumho Tire*, presented at the Defense Research Institute, Insurance Coverage and Practice Seminar, December 9-10, 1999.
- [209] 75 F.3d 290, 293 (7th Cir. 1996).
- [210] *See also* United States v. Hall, 165 F.3d 1095 (7th Cir. 1999).
- [211] *Kulak v. Nationwide Mut. Ins. Co.*, 351 N.E.2d 735 (N.Y. 1976) (citations omitted).
- [212] *Id.*
- [213] *Id.* at 740.
- [214] *Id.*
- [215] *Id.* at 742.
- [216] Patrick A. Krebs & Brian J. De Tray, *Kumho Tire v. Carmichael: A Flexible Approach to Analyzing Expert Testimony Under Daubert*, 34 TORT & INS. L.J. 989, 1003-04 (1999) (citation omitted).

- [217] 102 F.3d 256 (7th Cir. 1996).
- [218] *Id.* at 263.
- [219] *Id.* (emphasis added).
- [220] *Tassin v. Sears Roebuck & Co.*, 946 F. Supp. 1241, 1248 (E.D. La. 1996). For a discussion of the admissibility of computer models on environmental cases, see Allen Kezsbom & Alan V. Goldman, *The Boundaries of Groundwater Modeling Under the Law: Standards for Excluding Speculative Expert Testimony*, 27 TORT & INS. L.J. 109 (1991).
- [221] 890 F. Supp. 1417 (N.D. Iowa 1995).
- [222] *Id.* at 1447.
- [223] *Id.* at 1448.
- [224] 171 F.R.D. 305 (D.C. Kan. 1997).
- [225] No. 95-7550, 1997 U.S. Dist. LEXIS 2726 (E.D. Pa. Feb. 28, 1997).
- [226] 21 F. Supp. 2d 923 (E.D. Ark. 1998).
- [227] *Id.* at 934.
- [228] 158 F.3d 548 (11th Cir. 1998).
- [229] *Id.* at 563.
- [230] *Id.*
- [231] 969 F. Supp. 289 (E.D. Pa. 1997).
- [232] *Id.* at 299 n.7.
- [233] 121 F.3d 697 (4th Cir. 1997).
- [234] *Id.* at 697.
- [235] 140 F.3d 915 (11th Cir. 1998).
- [236] 37 F. Supp. 2d 532 (S.D. Tex. 1999).
- [237] *Id.* at 541.
- [238] 10 F. Supp. 2d 800 (E.D. Mich. 1998).
- [239] 30 F. Supp. 2d 101 (D. Mass. 1998).
- [240] *Id.* at 110.

- [\[241\]](#) 151 F.3d 269 (5th Cir. 1998), *cert. denied*, 119 S.Ct. 1454 (1999).
- [\[242\]](#) *Id.* at 279 (citing *Joiner*). See *Krebs & De Tray*, *supra* note 216, at 1007 and the dissenting opinion in *Moore*, 151 F.3d at 284, which calls for a grant of wide latitude to the district court when exercising its gatekeeping function.
- [\[243\]](#) *Krebs & De Tray*, *supra* note 216, at 1007 (citing *Tassin v. Sears Roebuck*, 946 F. Supp. at 1248).
- [\[244\]](#) 633 N.E.2d 451 (N.Y. 1994).
- [\[245\]](#) *Id.* at 455. See also *People v. Wernick*, 674 N.E.2d 322 (N.Y. 1996); *People v. Green*, 683 N.Y.S.2d 597 (App. Div. 1998); *People v. Roraback*, 662 N.Y.S.2d 327 (App. Div. 1997), *appeal denied*, 691 N.E.2d 649 (N.Y. 1997).
- [\[246\]](#) See *People v. Hughes*, 453 N.E.2d 848 (N.Y. 1983); *People v. Philips*, 692 N.Y.S.2d 915 (Sup. Ct. 1999).
- [\[247\]](#) *People v. Wernick*, 651 N.E.2d 392 (N.Y. 1996).
- [\[248\]](#) *Wesley*, 633 N.E.2d 451.
- [\[249\]](#) *People v. Persuad*, 665 N.Y.S.2d 671 (App. Div. 1997), *appeal denied*, 695 N.E.2d 724 (N.Y. 1998); *People v. DiNonno*, 659 N.Y.S.2d 390 (App. Term 1997).
- [\[250\]](#) 693 N.Y.S.2d 875 (Sup. Ct. 1999).
- [\[251\]](#) *Id.* at 877-78.
- [\[252\]](#) 705 N.Y.S.2d 792 (Sup. Ct. 1999).
- [\[253\]](#) *Id.* at 799.
- [\[254\]](#) *Id.* at 800.
- [\[255\]](#) *Id.*
- [\[256\]](#) *Id.* at 799.
- [\[257\]](#) 45 F. Supp. 2d 316 (S.D.N.Y. 1999).
- [\[258\]](#) *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 156 (1999).
- [\[259\]](#) 187 F.R.D. 77 (S.D.N.Y. 1999).
- [\[260\]](#) *Kumho*, 526 U.S. at 156.
- [\[261\]](#) *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997).

- [\[262\]](#) 151 F.3d 269 (5th Cir. 1998).
- [\[263\]](#) 201 F.3d 448 (10th Cir. 1999).
- [\[264\]](#) 23 F. Supp.2d 1298, 1303 (N.D. Okla. 1998) (citation omitted).
- [\[265\]](#) 1999 WL 1063826 at 2, n.2 (10th Cir. 1999).
- [\[266\]](#) 32 F.2d 513 (10th Cir. 1987).
- [\[267\]](#) *Id.* at 522 (citations omitted).
- [\[268\]](#) *See* 5 JACK B. WEINSTEIN & MARGARET A. BERGER,