Institutional Bad Faith: The Darth Vader of Extra-Contractual Litigation[†]

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I.
Introduction

Institutional bad faith is the "Ebola" virus of extra contractual litigation. Darth Vader manages the field hospital and it is completely run by plaintiffs. It can be seemingly innocuous at first and hard to recognize, but it can grow explosively and wreck not only litigation management budgets, but can also seriously deplete corporate equity and shareholder value. If properly conducted in the hands of a skilled plaintiff's attorney, it can create "bet the company" exposure, for all but the healthiest of insurance carriers. It rarely reaches the trial phase because of the exposures and the discovery aspect which is a key component. The typical case will start with fairly routine discovery, including interrogatories and requests for production, but will rapidly escalate into more aggressive requests for more and more information from not only claims handling, underwriting, and in house legal departments, but also high ranking executives and even board members. The purpose, of course, is to cast the insurance industry as an "evil empire" operating without conscience and calculated to destroy the hope of legitimate claimants. When one strips away the facade of righteousness that the plaintiffs' bar tries to create, one finds a naked effort to put the entire industry on trial and dramatically increase the punitive damage awards accordingly. Novel damage theories are forthcoming and are discussed in more detail hereafter.

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Decisions regarding the potential bad faith liability of insurance carriers routinely emanate from the West Virginia Supreme Court of Appeals. In some respects, these decisions are unique; yet, in other facets, the decisions have followed the majority of other jurisdictions, usually with some modification or expansion. Despite that, no institutional bad faith case has been reviewed by this activist court. The closest related was a hybrid case regarding infant summary proceedings against every insurance carrier ever to conduct business and effectuate an infant settlement in West Virginia for a twenty year period preceding the filing of the complaints.[1] This, of course, is explained by the infant's rights to challenge said settlements upon reaching the age of majority and for a period of two years thereafter. Although the term "institutional bad faith" is not mentioned as such in the various appellate decisions arising out of this litigation that is precisely what it was: an attack on the entire industry. Interestingly, the defense prevailed for all but one insurance carrier, and even though the settlement amount with that carrier is confidential, it is thought to be in the tens of millions of dollars, if not higher.

Obviously, this is not litigation for the faint hearted, especially on the plaintiff's side, as this litigation is time consuming and very expensive. Because the early warning signals are sometimes very difficult to read, missteps in the discovery process at an early stage can create enormous openings for extensive discovery into all phases of corporate activity, including the financial division. The nature and scope of such risk is too broad and detailed for this article.

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[1] State ex rel. W. Va. Fire & Cas. Co. v. Karl, 487 S.E.2d 336 (W. Va. 1997)("Karl I").



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II.
Class Actions or "Mere" Multi-plaintiff Cases

A very activist plaintiffs' bar in West Virginia is constantly probing for areas to expand insurance bad faith claims. It is worthy of note that bad faith is a cause of action the plaintiff's attorney *can actually create after* signing up the underlying tort claim. Thus, what started as a small, focused attack on the insurance industry is growing to include virtually every plaintiffs' firm with a personal injury base. Upon discovery of a common theme, discovery demands are then filed for "other claims" files. The fairly recent United States Supreme Court decision in *State Farm Mutual Automobile Insurance Co. v. Campbell*,[2] has placed significant barriers in the path of plaintiffs' attorneys seeking "other claims" discovery. The realistic problem is that many courts interpret *Campbell* in different ways, but, at a minimum, the discovery of other claims files should be limited to a single state. The aforementioned hybrid case involved a very capable plaintiff's attorney who had been retained to represent a minor and his mother regarding an infant settlement that had been secured *without* obtaining court approval through a summary proceeding and prior to retention of counsel, when the plaintiffs had no representation. The plaintiffs' counsel initially maintained that obtaining a settlement of the infant claim from the mother without the use of a summary proceeding

[2] 538 U.S. 408 (U.S. 2003).



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violated the West Virginia Unfair Claims Settlement Practices Act.[3] In its first opportunity to address this case, the West Virginia Supreme Court of Appeals held that "W. Va. Code, 44-10-14 [1929] does *not* require court approval of all claims where a guardian executes a settlement agreement on behalf of minor who has been injured in his or her person or property."[4] Unfortunately, a footnote in *Karl I* left open other areas of pursuit.[5]

A collateral issue arising out of this case related to whether the plaintiffs were entitled or should be permitted to discover other non-litigant claims files maintained by the insurance carrier involving infant settlements that had been obtained without court approval. The plaintiffs' counsel argued these were sought for discovery of "other bad acts, to demonstrate a general business practice, or to identify a proposed class."[6] The trial court ordered production of these non-litigant claims files which led to the filing of a petition for writ of prohibition against the trial court judge (Karl).

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[3] W. Va. Code § 33-11-4(9) (2006); see case cited *infra* note 5.

[4] Karl I, 487 S.E.2d at 343 (emphasis added). West Virginia Code § 44-10-14 provides, in part:

> In any case where an infant is injured in his person or his property by another, the legal guardian of such infant may negotiate with the person inflicting such injury for the settlement of any claim for damages therefor. But the guardian shall, when proceeding under this section, before making final settlement, file his petition in equity with the circuit court of the county, or judge thereof in vacation, in which he was appointed, for permission to settle such claim, in which petition he shall state the name and age of his ward, the nature and character of the injury, and the facts relied upon by him to induce the court of judge to approve such proposed settlement . . .

[5] Karl I, 487 S.E.2d at 343, n.8.

[6] State ex rel. W. Va. Fire & Cas. Co. v. Karl, 505 S.E.2d 210, 213 n.5 (W. Va. 1998)["Karl II"].

The defense asserted that production of these files in their entirety would violate the privacy rights of the non-litigants and could subject the insurance carrier to liability for the production of confidential, personal, and medical information of the non-litigant individuals. As a means of attempting to resolve the discovery dispute, while at the same time preserving the confidentiality of those individuals who were the subject of the requested claims files, defense counsel presented a potential resolution to the privacy issue by relying upon a California decision, *Colonial Life & Accident Insurance Co. v. Superior Court*,[7] resolved a similar discovery dispute with limited redacted discovery. This potential solution was, not surprisingly, rejected by plaintiffs' counsel.

In addressing the requested writ, the West Virginia Supreme Court of Appeals weighed the plaintiffs' need to obtain the requested information against the burden that producing the information placed upon the insurance carrier and further balanced the interests of the party litigants against the privacy rights of the non-litigants whose claims files were sought.[8] Thus, the court granted the requested writ, as modified, and required the insurance carrier to produce *redacted* copies of the infant claim portions of the requested claims files. All contacts with prior claimants had to go through a court selected neutral party. The court further observed that the insurance carrier could adequately protect the privacy interests of the non-litigants by *completely* redacting the names, addresses, personal medical information and other identifying material from the records prior to disclosure because "the insurer's 'interest in protecting the privacy rights of its claimants clearly outweighs any right the real parties in interest have to discover the identities of the other claimants.'"[9] Clearly then, this court-sanctioned redaction of any and all identifying information of the non-litigant claimants significantly impairs the ability of plaintiff's counsel to identify a proposed class for purposes of a class action pursuant to Rule 23 of the West Virginia Rules of Civil Procedure.[10] The opinion is important because plaintiffs' counsel had alleged the need for class certification, but had not yet had it certified.

Finally, the *Karl II* court addressed the possibility that the plaintiffs would seek additional information or testimony that would necessitate release of a non-litigant's name or personal information. In so doing, the court provided that the plaintiff could petition the trial court for the production of such information. One approach suggested by the appellate court that could be utilized by the trial court would be that approved in *Colonial Life*, wherein the court directed that letters of consent from the non-litigants be required prior to release of any

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7 647 P.2d 86 (Cal. 1982).

8 *Karl II*, 505 S.E.2d at 215.

9 *Id*. at 215 (quoting Alpha Life Ins. Co. v. Gayle, 796 S.W.2d 834, 836 (Tex. App. 1990)).

10 W. Va. R. Civ. P. 23, *available at* http://www.state.wv.us/wvsca/rules/civilproc/IV.htm.

personal or identifying information from any non-litigant. Without this redaction principle, it would have been a virtual certainty that this case would have ended as a class action. As it was, it resulted in a confidential settlement.

It is noteworthy that the aforementioned case could not currently be brought in West Virginia due to a repeal of third-party bad faith. It could now only be brought pursuant to first-party coverages such as underinsured motorist ("UIM") and uninsured motorist ("UM") coverage.

III.
New Trends in Damage Enhancement and Defenses Thereto

One of the most dangerous new damages theories being advanced is a direct attack on an insurance carrier's A.M. Best's rating. The argument is such that plaintiffs are proffering this as the only adequate way to "get the carrier's management's attention." Because this effectively jeopardizes the carrier's economic competitiveness, the mere approach is, in fact, an "attention getter." No case has yet reached the appellate stage on this new theory, but it has been used in numerous pending West Virginia cases. The reduction of one's A.M. Best's rating by one "notch" can be a very large number. The methodology of the approach this author has seen used is flawed and unscientific, yet only a determined counter-attack can minimize the impact if a jury is allowed to hear the evidence. It has an obvious value as it pertains to case evaluation for settlement, because the flaws could be cured.

IV.
Trends: Expanding Insurer's Apparent Net Worth By Naming Affiliates

Another emerging tactic in the area of insurance law, currently utilized by creative plaintiffs' attorneys, relates to the strategem of expanding the insurance carrier's *apparent* economic worth, for punitive damages purposes, by naming, as party defendants, subsidiaries or affiliates of the defendant insurance carrier. One such example of this can be found in *Oliver v. Farmers Insurance Group*.[11]

In *Oliver*, the plaintiff filed a claim against her insurance carrier, Farmers Insurance Company, for bad faith in the handling of her alleged loss under her uninsured motorist policy. In addition, the plaintiff named three other parties as defendants, claiming that all were responsible as members of the Farmers Insurance Group. Two of the defendants, Farmers Insurance Group of Companies and Farmers Group, Inc. filed motions for summary judgment, alleging that they were improper defendants in the bad faith action. In response to the motions for summary judgment, the plaintiff presented an organizational chart detailing the hierarchy of the Farmers companies and an affidavit of the former Oklahoma Insurance

[11] 941 P.2d 985 (Okla. 1997).

Commissioner stating, in part, that the "Farmers Insurance Group is but one entity that is supervised and managed by Farmers Group, Inc."[12] The trial court granted summary judgment to the two defendants and the plaintiff appealed. The Supreme Court of Oklahoma reversed and remanded for further proceedings.

In addressing the plaintiff's appeal, the court noted that:

> [The] Plaintiff is candid in disclosing her motive in naming the additional defendants. She bought the insurance through an agency that advertised as representing the "Farmers Insurance Group". Her policy was actually written with "Farmers Insurance Company, Inc.", a Kansas corporation and rather small subsidiary. In her bad faith claim for punitive damages she hopes to be allowed to show the worth of more than just the Kansas subsidiary.[13]

The court further addressed the fact that two other courts had faced this exact question and dealt with this particular defendant.[14] "Both courts held that as the management company and attorney-in-fact for all of its subsidiary and affiliated companies, it could be held liable for bad faith breach of contract."[15] In reversing the trial court order granting summary judgment, the supreme court provided:

> No one suggests that the companies which "associate themselves together" in the Farmers Group do not "transact business for gain." Whatever else Farmers Insurance Group of Companies does, it is clearly a name under which a number of Farmers-

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[12] *Id*. at 986.

[13] *Id*. at 987.

[14] *Id*. at 987 (citing Farmers Group, Inc. v. Trimble, 768 P.2d 1243 (Colo. Ct. App. 1988); Delos v. Farmers Ins. Group, Inc., 155 Cal. Rptr. 843 (Ct. App. 1979)). *See also* Williams v. Farmers Ins. Group, Inc., 781 P.2d 156 (Colo. Ct. App. 1989). In this case the plaintiffs were insured with Mid-Century Insurance Company at the time of their involvement in a single vehicle accident. Subsequently, they filed suit against Mid-Century and Farmers Insurance Group for bad faith breach of the insurance contract. Farmers claimed that it did not conduct business in Colorado and was simply the attorney in fact and the management company for handling claims against Mid-Century. Addressing this unique relationship, the court provided:

> Given this relationship, policyholders submitting claims deal with Farmers in the handling and processing and payment or denial of their claims, even though they have contracted for insurance coverage with Mid-Century or another member of Farmers' subsidiary or affiliated insurance companies. Thus, strict adherence to the general rule that liability for bad faith breach may be imposed only against a party to the insurance contract would permit Farmers to shield itself from liability through the device of a management company. This would deny plaintiffs recovery from the claims-handling entity primarily responsible for their damages . . . Therefore, we hold that Farmers is liable for the claims asserted here.

Williams, 781 P.2d at 158 (citation omitted).

[15] *Oliver*, 941 P.2d at 988.

> related companies insure against risks. Under our section 182 [the plaintiff] may properly bring suit against Farmers Insurance Group of Companies. Any ultimate liability of companies in The Group other than the original defendant would be dependent on the plaintiff's ability to show the "control" factors articulated in Frazier.[16]

Clearly then, there does exist the very real possibility, depending upon the organizational structure of the particular insurance carrier, of expanding the assets of the party defendant for purposes of punitive damages by naming as additional party defendants subsidiaries and affiliates of the defendant insurance carrier. The basis often used for this joinder is contained in advertising information on the company's internet website. A critical review of each such site is encouraged.

V.
Class Action Bad Faith

This is institutional bad faith, perversely expressed. Keeping in mind that bad faith is typically litigated as specific wrongs against a specific individual, efforts to expand this into a class seem to run contrary to traditional notions. Cases are being presented in lower courts where efforts are being made to recover bad faith damages for a group of similarly situated claimants, only one of which actually asserted and litigated a claim. The argument of necessity becomes that by certifying an underlying class and invoking the general business practice evidence utilized in the single claim on behalf of an entire class, there is an acceptable mechanism of a class wide assessment of punitive relief. These typically arise in situations in which the affected claimant has virtually identical issues as all other members of the putative class. The plaintiff then asserts that the one claim and the claims handling thereof is reflective of the defendant's attitude toward the entire class, and seeks relief therefore. As with many of the institutional bad faith cases, this may start with a fairly small claim, and early detection is necessary.

VI.
Conclusion

May the force be with you!!!!

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[16] *Id.* (citing Frazier v. Bryan Mem'l Hosp. Auth., 775 P.2d 281 (Okla. 1989)).