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Insurance Bad Faith

Recent Cases Discussing The Advice Of Counsel Defense: The Good, The Bad, And The Discovery

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Commentary

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Introduction

The gravamen of a third-party claim of bad faith is that the insurer failed to settle a claim against an insured when it had the opportunity to do so.[1] The essence of the claim is that the insurer acted solely on the basis of its own interests, failed to properly and promptly defend the claim, and thereby exposed the insured to an excess judgment.[2] However, a claim based on insurer negligence is insufficient to establish bad faith.[3] In assessing whether an insurer has acted in bad faith, courts will consider a variety of circumstances. Some courts permit an insurer to assert reliance on the advice of counsel as an affirmative defense, or at least consider it as a factor,[4] in determining bad faith, while others refuse to recognize this defense.[5]

This article will discuss some of the recent opinions that discuss the application of the defense of the advice of counsel and some of the discovery issues that arise when the defense is presented.

The Good

In determining whether an insurer's actions, including denial of benefits, are reasonable a court may consider whether the insurance company relied on the advice of its counsel as a possible defense.[6] However, reliance on counsel does not automatically insulate an insurer from bad faith.[7] In assessing whether reliance on the advice of counsel precludes bad faith, courts will consider such factors as whether the insurer knew the legal standard involved such that it could determine whether the advice of counsel was erroneous and whether the insurer made a full disclosure of all relevant facts to its counsel.[8]

In *Chaidez v. Progressive Choice Ins. Co.*, a first-party action involving the theft of a vehicle, the court reviewed counsel's opinion letter and the information he relied upon, including the recorded statement and examination under oath of the insured.[9] The initial consideration for the court was whether the insurer thoroughly investigated the plaintiff's claim prior to denying it, "for if an insurer does not fully inquire into the bases of an insured's claim before denying it, the insurer cannot be found to have denied the benefits to the insured reasonably and in good faith."[10] The court determined that the insurer's reliance on the advice of its counsel was reasonable and precluded a finding of bad faith.[11]

In *Westchester Fire Ins. Co. v. Mid-Continent Cas. Co.*, an excess insurer sued the primary carrier for bad faith in failing to settle a claim within the limits of the primary policy.[12] The underlying accident related to a plaintiff who sustained multiple injuries, including brain damage, fractures, and urological impairment as a result of operating a concrete mixer. The primary carrier had issued a $1 million liability policy to the manufacturer of the concrete mixer. The primary carrier retained counsel

to defend the underlying liability lawsuit. Its counsel conducted several mock juries. As a result of the mock juries, the primary insurer believed this matter had a potential jury value of $1.6 million to $2 million.[13] However, the insurance adjuster believed the plaintiff would be found 75% to 90% comparatively negligent.[14] Counsel for the primary insurer believed that there was a 70% chance of a defense verdict, a net verdict exposure of $650,000 and a settlement value of $150,000 to $300,000.[15] As a result, the primary insurer never made a settlement offer higher than $150,000.

The excess carrier issued approximately five demands to the primary to settle the suit prior to trial. Although most of Plaintiff's offers remained above $2 million, the court found that Plaintiff had made one settlement demand prior to trial within the primary insurer's policy limits.[16] The underlying matter was ultimately tried to a jury, who awarded the plaintiff $1,705,173.[17] The primary insurer believed it would receive a set-off and the net award would not exceed $1.6 million. Plaintiff then wrote to the insurer and demanded $1.6 million. The primary insurer failed to provide this demand to the excess carrier and failed to advise them of its rejection of this offer.[18] The Court entered a final judgment in the amount of $1,990,173.[19]

The excess carrier then filed the instant suit against the primary carrier for bad faith. The court divided its analysis between the pre-verdict and post-verdict conduct of the primary insurer. For the pre-verdict conduct, the court found that the insurer had not acted in bad faith.[20] The court found that the primary insurer had reasonably investigated the matter, and reasonably relied upon the advice of its "accomplished trial attorney."[21] The primary insurer was reasonable in rejecting the settlement offers, within the policy limits, made prior to and during trial as nothing had occurred to change its evaluation of the case or its anticipation of a verdict.[22]

However, the court found that the primary insurer's "hasty dismissal" of the $1.6 million demand after the verdict was a decision made in its own interest and without any consultation with the excess insurer.[23] As such, the primary insurer's post-verdict conduct supported a finding of bad faith.[24]

The Bad

As briefly discussed above, reasonable reliance on counsel requires an element of evaluating whether the advice is, in fact, reliable.[25] There are also times where the actions of counsel may be considered one of the contributing factors of the bad faith claim. While not directly bad faith decisions, the following are some examples of malpractice claims arising from bad faith suits.[26]

In *Hartford Ins. Co. v. Koeppel*, an insurer sued its retained counsel for malpractice and breach of contract under a third-party beneficiary theory.[27] The insurer had retained counsel to respond to a demand letter from a third-party related to an auto accident involving the insured. Early on, the insurer had assessed the claim that it would likely "greatly exceed" the policy limits.[28] The insurer tendered its policy limits, but the tender was not accepted.[29] The insurer notified the insured of the potential excess exposure and advised that he retain personal legal counsel. The insurer then continued its efforts to resolve the claim within its policy limits.

Opposing counsel then issued a time-sensitive policy limit demand, offering to settle the claim for policy limits and a "mutual notarized general release." The insurer retained counsel to accept the demand and draft the release. However, the terms of the demand were not met. In the subsequent suit, the insurer claims that retained counsel negligently responded to the demand letter, resulting in a lawsuit against the insured and an eventual settlement substantially in excess of the policy limits.[30] The insurer then commenced the instant suit against the retained counsel.

Counsel moved to dismiss this lawsuit claiming that his duty was to the insureds alone.[31] However, the court explained the tripartite relationship between the insured, counsel, and the insurer retaining that counsel, with both the insurer and insured as co-clients.[32] As such, the suit was allowed to proceed.

In *U.S. Specialty Ins. Co. v. Burd*, the insurer retained counsel shortly after an accident to assist and defend the insured against claims related to an accident, with the understanding that these claims would likely exceed the policy limits.[33] Counsel then monitored the situation, so he would be up to speed "should matters turn ugly."[34] During the initial period, the insurer attempted to settle the claim for $850,000 on a $1 million policy, but the claimant's counsel rejected the offer and advised that the policy limits would not be enough to settle the claim. For the first time, at this point, counsel wrote to

the insured and advised of his retention to represent it.[35] The claimant filed suit and counsel responded with a letter expressing his surprise because he thought an agreement had been reached.[36] Plaintiff's counsel claimed bad faith.[37] The insurer ultimately settled for $9 million three years later.[38]

The court noted that while counsel had been hired to represent the insured, it also owed a duty to advise the insurer with reasonable care.[39] The court also noted that no coverage defense would be asserted and that a settlement needed to be effected in a way to maximize the benefit to the insured.[40]

The Discovery

When an insured asserts a bad-faith claim against his insurer in the way that the claim was handled, unique considerations arise.[41] Once a claim for bad faith has been asserted, an insured needs access to the insurer's file to discover facts to support its claim.[42] However, the insurer may overcome the presumption of discoverability by showing that its attorney was not engaged in the quasi-fiduciary tasks of investigating and evaluating or processing the claim, but instead in providing the insurer with counsel as to its own potential liability, including whether or not coverage exists.[43] Simply asserting the defense of compliance with the law is not the same as relying on the advice of counsel.[44] Advice of counsel is raised only when the client asserts a claim or defense and attempts to prove the claim or defense by disclosing or describing an attorney-client communication.[45]

In *City of Glendale v. National Union Ins. Co. of Pittsburgh, PA*, the city submitted a claim to its insurer for defense costs and indemnification related to an underlying lawsuit.[46] The insurer retained outside counsel to prepare a coverage opinion. Based in some part on this opinion, the insurer denied coverage. The underlying lawsuit was tried to a verdict of approximately $2.2. million against the city.

The city then sued the insurer for bad faith. The insurer retained local outside counsel, who also prepared an opinion that the underlying litigation did not trigger coverage.[47] The city served discovery requests seeking the insurer's entire file related to the underlying lawsuit, along with all coverage opinion letters. The insurer objected based upon work product and attorney-client privilege.[48]

The insurer acknowledged that by asserting the defense of advice of counsel, it had waived attorney-client privilege as to the first coverage opinion.[49] However, they did not believe this waiver extended to the second opinion letter, "because they did not rely upon any coverage advice from that firm."[50] The city argued that the waiver of attorney-client privilege based upon the advice of counsel defense extended to any communications related to the coverage analysis. The city also argued that the insurer may also be liable for bad faith based upon the conduct of outside counsel.[51]

The court noted that when a litigant seeks to establish its mental state by asserting that it acted after investigating the law and reaching the belief that the law permitted the action it took, then the actions it took, including the advice received from counsel, remain relevant.[52] This privilege is not waived just to the advice the insurer accepts or relies upon.[53] To hold otherwise would permit an insurer to claim it relied upon advice that supports its opinion but did not rely upon contrary advice.[54]

The city also sought the information in outside counsel's files, including information not communicated to the insurer, arguing that the duty of good faith could not be delegated to another party, including counsel.[55] The court rejected this argument as the waiver only applied to information actually received from outside counsel.[56] The court, however, did permit discovery of other coverage opinions the insurer received from the instant outside counsel as they may be relevant to demonstrate that the insurer received inconsistent advice or have acted inconsistently in response to coverage advice.[57] However, this waiver did not extend to coverage opinions received after the coverage decisions in this case.[58] The waiver also did not extend to attorney-client communications related to the instant bad faith suit and not the coverage analysis.[59]

Conclusion

While many insurers pride themselves on never having to rely on the advice of counsel defense, it remains a viable arrow in the quiver of defenses available. In the instances where it is asserted, an insurer needs to be aware of the developing case law and how its own actions will

be scrutinized regarding its reliance on that advice and how it will impact discovery in the lawsuit.

Endnotes

1. *See* Contreras v. U.S. Sec. Ins. Co. 927 So. 2d 16, 20 (Fla. 4th DCA 2006).

2. *See* Merret v. Liberty Mut. Ins. Co. 2013 WL 1245860 (M.D. Fla. March 27, 2013).

3. *See* Novoa v. GEICO Indem. Co., 2013 WL 5614269 (11th Cir. Oct. 15, 2013).

4. *See* Davis v. Cotton Mut. Ins. Co., 604 So. 2d 354 (Ala. 1992); Stewart v. Truck Ins. Exch., 17 Cal. App. 4th 468, 21. Cal. Rptr. 2d 338 (2d Dist. 1993), reh'g denied (Aug. 23, 1993)(reliance on advice of counsel negated proof of malice, oppression or fraud); State Farm Mut. Auto. Ins. Co. v. Superior Court (Johnson Kinsey, Inc.), 228 Cal. App. 3d 721, 279 Cal. Rptr. 116 (4th Dist. 1991); Brandon v. Sterling Colorado Beef Co., 827 P.2d 559 (Colo. Ct. App. 991); Empire Fire & Marine Ins. Co. v. Simpsonville Wrecker Service, Inc., 880 S.W.2d 886 (Ky. Ct. App. 1994); Boston Symphony Orchestra, Inc. v. Commercial Union Ins. Co., 406 Mass. 7, 545 N.E.2d 1156 (1989); St. Paul Surplus Lines Ins. Co. v. Dal-Worth Tank Co., 917 S.W.2d 20 (Tex. App. 1995)(consultation with counsel is merely factor in determining reasonableness of the insurer's conduct); Larsen v. Allstate Ins. Co., 857 P.2d 263 (Utah Ct. App. 1993); Western Line Consl. School Dist. V. Continental Cas. Co., 632 F. Supp. 295 (N.D. Miss 1986)(advice of counsel excused insurer's delay); Gorman v. Southeastern Fidelity Ins. Co., 775 F.2d 655 (5th Cir. 1985)(reliance on advice of counsel may preclude awarding punitive damages).

5. *See* Giampapa v. American Family Mut. Ins. Co., 919 P.2d 838 (Colo. Ct. App. 1995), reh'g denied, (Dec. 21, 1995), cert. denied (June 17, 1996); Smoot v. State Farm Mut. Auto Ins. Co., 299 F.2d 525, 530 (5th Cir. 1962); Decker v. Amalgamated Mut. Cas. Ins. Co., 35 N.Y.2d 950, 365 N.Y.S. 2d 172, 324 N.E. 2d 552 (1974); Klinger v. State Farm Mut. Auto. Ins. Co., 115 F.3d 230 (3rd Cir. 1997); Blakely v. American Emp. Ins. Co., 424 F.2d 728, 734 (5th Cir. 1970); Timmons v. Royal Globe Ins. Co., 653 P.2d 907, 914 (Okla. 1982); Beacon Nat'l Ins. Co. v. Reynolds, 799 S.W.2d 390 (Tex. App. Forth Worth 1990)(trial court properly excluded evidence of attorney's advice where the insured requested the advice only after having received an inquiry from the insurance department and had not relied upon the advice when denying the insured's claim).

6. *See* Chaidez v. Progressive Choice Ins. Co., 2013 WL 1935362 at *5 (C.D. Cal, May 9, 2013).

7. *Id.*

8. *Id.* at *6, citing Andrade v. Infinity Ins. Co., 2009 WL 3427928 at *2 (C.D. Cal. Sept. 14, 2009).

9. 2013 WL 1935362 at *5 (C.D. Cal, May 9, 2013).

10. *Id.* at *5.

11. *Id.* at *6.

12. 2013 WL 3189053 (S. D. Fla. June 21, 2013).

13. *Id.* at *2.

14. *Id.*

15. *Id.* at *3.

16. *Id.* at *6.

17. *Id.* at *4.

18. *Id.* at *4.

19. *Id.*

20. *Id.* at *8.

21. *Id.* at *7.

22. *Id.* The insurer's counsel had estimated a maximum verdict exposure of $1,150,000, with no reduction for a workers' compensation lien, and only a 30% chance of this maximum verdict.

23. *Id.* at *9.

24. *Id.*

25. *See* Johnson v. Government Employees Ins. Co., 2008 WL 3927469 (W.D. Okla. Aug. 21, 2008) (noting that reliance on the advice of counsel can be a defense, but the reliance on counsel's advice must be reasonable).

26. Admittedly, these are extreme examples chosen to demonstrate the point. Please note that some jurisdictions will not hold an insurer vicariously liable for the actions of its retained counsel. *See* Aetna Cas. & Sur. Co. v. Protective Nat'l Ins. Co of Omaha, 631 So. 2d 305 (Fla. 3d DCA 1993)(holding no vicarious liability for malpractice of counsel). *See also* Marlin v. State Farm Mut. Auto. Ins. Co., 761 So. 2d 380 (Fla. 4th DCA 2000).

27. 629 F. Supp. 2d 1293 (M.D. Fla. 2009).

28. *Id.* at 1296.

29. *Id.* Note that under Florida law, a liability insurer has an obligation to initiate settlement negotiations, even prior to receiving a demand, in cases where liability is clear and injuries are so serious that a judgment in excess of the policy limits is likely. Powell v. Prudential Prop. & Cas. Ins. Co., 584 So. 2d 12 (Fla. 3d DCA 1991).

30. *Id.* at 1297.

31. *Id.* at 1297.

32. *Id.* at 1299. The court cited to General Security Ins. Co. v. Jordan, Coyne & Savits LLP., 357 F. Supp. 2d 951 (E.D. Va. 2005) for a summary of the majority and minority views with respect to the counsel and insurer relationship.

33. 833 F. Supp. 2d 1348 (M.D. Fla. 2011).

34. *Id.* at 1357, n.19, noting that matters "got ugly" when counsel responded to the lawsuit.

35. *Id.* at 1351-2.

36. *Id.* at 1352.

37. *Id.* at 1352.

38. *Id.*

39. *Id.* at 1357.

40. *Id.* at 1355-6.

41. *See* Cedell v. Farmers Ins. Co. of Washington, 295 P.3d 239, 244 (Wash. 2013). Cedell is a first-party property action.

42. *Id.* at 245.

43. *Id.* at 246.

44. *See* Walter v. Travelers Personal Ins. Co., 2013 WL 2252729 at *6 (M.D. Pa. May 22, 2013).

45. *Id.*, citing George v. Wausau Ins. Co., 2000 WL 276915 (E.D. Pa. March 13, 2000).

46. 2013 WL 1797308 (D. Ariz. April 29, 2013).

47. *Id.* at *1.

48. *Id.* at *2.

49. *Id.* at *3.

50. *Id.*

51. *Id.* at *3.

52. *Id.* at *4.

53. *Id.* at *5.

54. *Id.*

55. *Id.* at *6.

56. *Id.* at *7.

57. *Id.* at *9.

58. *Id.* at *9.

59. *Id.* at *10. ■

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