

Insurance Bad Faith

A Wolf In Sheep's Clothing (Insurers Should Be Vigilant In Florida)

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Commentary

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Florida is not known for its kindness to insurance companies. As a zealous architect of bad-faith laws, Florida has earned its reputation among insurance companies. This article focuses on how, over time, Florida has formulated an atmosphere requiring vigilance by insurance companies.

I. Introduction – Through The Wood

*As she was going through the wood, she met a wolf, who had a very great mind to eat her up.*¹

In Florida, as elsewhere, an insurance policy was once treated like any other contract. If policy benefits were available, but not paid, then the insured would sue for breach of contract. In the 1930s, the insurance landscape changed because of an increase in highway travel, congested traffic, and automobile accidents.² Traditional indemnity policies were replaced by liability policies, which bestowed upon insurance companies not only the obligation to pay for losses incurred by the insured, but also the responsibility of defending the insured against allegations of wrongdoing.³

Under this new type of insurance policy, insurers took over control of settlement decisions. Insureds would be

forced to rely on the insurance company to make these settlement decisions in good faith, and to protect the insureds from liability in excess of policy limits.⁴ This transfer of control placed insurers in a fiduciary relationship with their insureds.⁵ The insurance company now owed a duty to refrain from acting solely in its own interest, which became the hallmark of insurer "good faith."⁶ An insurer that did not act in "good faith" would have to pay the entire judgment entered against its insured, even if the amount exceeded insurance policy limits.⁷ In 1938, when the Supreme Court of Florida recognized that an insured could sue for breach of the insurer's fiduciary duty to act in "good faith" in defense and settlement decisions,⁸ insurers did not fully recognize the danger.

II. The Unexpected – Lying in Wait

The wolf dispatched Little Red's grandmother and put on her bedclothes, waiting for the girl to arrive.

For the next forty years, this "bad faith failure to settle" action (now commonly referred to as a "third-party bad faith" action) was the only recognized exception to the general rule that insurers could only be sued for breach of contract as a result of poor claim handling. Insurers accepted the responsibility of settling and defending third-party actions brought against their insureds. Meanwhile, the legal duties of the insurer's fiduciary responsibilities were scrutinized and defined through developing case law. Insurers continued on their journey, unaware of the peril ahead.

III. Broadened Reach – The Wolf's Big Arms

She was greatly amazed to see how her grandmother looked in her nightclothes, and said to her, "Grandmother, what big arms you have!"

In 1971, the Supreme Court of Florida extended the reach of the “third-party bad faith” action, by allowing injured third-party claimants to sue the defending insurance company directly.⁹ The reason given for allowing injured third parties to sue the other party’s insurer for bad faith was to ensure that insurance companies would use their best efforts to settle the underlying automobile accident disputes.¹⁰

Ironically, this shift in public policy, which now allows third-party claimants to sue the opposing party’s insurance company for bad faith, had the practical effect of deterring some third-party claimants from settling accident claims. Injured third parties started to engage in tactics calculated to make it difficult (or impossible) for the insurer to secure settlement on behalf of its insured. Knowing that an insurer’s failure to settle could allow extra-contractual recovery, claimants refused to engage in reasonable settlement negotiations. The goal was to get past insurance policy limits. This strategy became known throughout the insurance industry as a “bad faith set-up.” The Supreme Court of Florida’s 1971 recognition of a third-party’s right to sue insurers directly for failing to settle their claims may have been intended to promote settlement, but also brought accident liability lawsuits and bad-faith actions on claims that otherwise may have been settled.

IV. In Retrospect – A View Of The Danger Ahead

“Grandmother, what big eyes you have!”

In 1980, the Supreme Court of Florida entered a landmark decision known as *Boston Old Colony Insurance Company v. Gutierrez*.¹¹ Florida’s high court looked back upon the reported decisions that developed over the years and tabulated the myriad obligations of an insurance company to its insured: (1) to place its own interests aside in making settlement decisions, (2) to advise the insured of settlement opportunities, (3) to advise as to the probable outcome of the litigation, (4) to warn of the possibility of an excess judgment, (5) to advise the insured of any steps he or she might take to avoid an excess judgment, (6) to investigate the facts with due diligence and care, (7) to give fair consideration to a settlement offer that is not unreasonable under the facts, (8) to exercise due care in its evaluation of the claim against the insured, and (9) to settle, if possible, where a reasonably prudent person, faced with the prospect of paying the total recovery, would do so.¹²

Significantly, the Supreme Court of Florida made clear that “[t]he question of failure to act in good faith with due regards for the interests of the insured is for the jury.”¹³ The burden of proving bad faith in Florida is more relaxed than proving intentional wrongdoing or reckless disregard for the rights of the insured. To prove bad faith, even evidence of the insurer’s simple negligence is admissible.¹⁴ Bad faith is also harder to defend in Florida than in most jurisdictions. In most states, the insurer’s claim decision only has to be justifiable to avert an action alleging bad faith. If reasonable minds could differ as to whether the claim decision was a sound one, then there is no bad faith. Florida’s standard is tougher on insurers. In Florida, an insurer may be held liable even if it had a good faith basis for the decision it made. Since the issue of “bad faith” is usually one for a jury, summary judgment is more difficult to come by and litigation can be time consuming and expensive.¹⁵

Moreover, since third-party claimants have been given an incentive not to settle their claims, it is more difficult to avert litigation. In fact, one of the Supreme Court Justices in *Gutierrez* concurred specially to focus on the rule of law created in 1971 which allowed third-party claimants to sue the defendant’s insurance company directly.¹⁶ Justice Alderman saw the danger coming:

I believe an injured tort plaintiff should not be allowed to bring an action directly against a tortfeasor’s insurer for bad faith failure to settle a claim because, in my opinion, the insurer’s good faith duty to settle runs only to its insured.

* * *

In the “Alice-In-Wonderland” world created by [allowing the injured plaintiff to sue a defendant’s insurance company for ‘bad faith’ directly], it is to the injured party’s benefit if the insurer breaches its duty to its insured and to his detriment if there is no breach. This is so since, if the insurer settles, the plaintiff will receive no more than the policy limits, but if it does not, a plaintiff may end up with both the policy limits and an excess judgment.¹⁷

Focused on the prospect that forcing insurers to engage in self-regulation might lessen the number of accident lawsuits, the Supreme Court majority chose to overlook the potential for abuse by third-party claimants who

could sue insurers directly for bad faith failure to settle their claims. As a result, bad faith set-ups by the plaintiffs' bar increased exponentially.¹⁸

V. Springing Into Action – By Leaps And Bounds

“Grandmother, what big legs you have!”

In 1982, the Florida Legislature modified the common law by creating a statutory cause of action for first-party bad faith. Until 1982, Florida continued to limit insurer bad faith to the third-party failure to settle context. The kind of fiduciary duty that existed when an insurance company took over control of settlement negotiations involving third parties simply did not exist in the first-party context where an insured was seeking his or her own insurance benefits. Florida courts had refused to recognize any action for “bad faith” in the first-party context because an insurer’s failure to pay a first-party claim of its own insured would not expose the insured to excess liability.¹⁹ The new statute, however, was “designed and intended to provide a civil remedy for any person damaged by an insurer’s conduct.”²⁰ Thus, the same obligations of good faith that existed for the protection of insureds against third-party claims were extended by statute to the first-party context.

The new statute did not supersede or preclude any other theory of recovery against an insurance company, such as independent torts like fraud or intentional infliction of emotional distress.²¹ To the contrary, the statutory cause of action for bad faith was expressly co-extensive with other available remedies.²² Under the statute, plaintiffs were now permitted to select whatever legal theories they preferred. A plaintiff could sue for simple bad faith, other statutory violations, common law torts, or any combination thereof. If the alleged wrongdoing implicated the insurer’s general business practices, then a plaintiff could decide to pursue an individual “bad faith” action or seek class-wide relief. More aggressive litigants could file a multi-count complaint in an effort to benefit from both the easier-to-prove “bad faith” cause of action and more complex theories intended to bring a punitive damage award.

The enactment of Florida’s bad faith statute marked “open season” for insureds and third-party claimants alike to hunt insurance companies. The plaintiffs’ bar capitalized on the favorable conditions created by both Florida’s legislature and its judiciary. Florida lawsuits targeting insurers became prolific. Insurance companies

confronted premeditated legal tactics designed to force them into compromising on questionable first-party and third-party claims. The ultimate reward of even the slightest mistake by an insurance company could be a recovery in excess of insurance policy limits. The practical effect is that insurers would not only have to be more watchful, but would also be forced to pay more indemnity dollars to avoid the expense of and risk of exposure in extra-contractual litigation.

VI. Listening Without Empathy – Hearing But Not Agreeing

“Grandmother, what big ears you have!”

In 2004, the Supreme Court of Florida debated whether to hinder sophisticated legal strategies that were specifically designed to force insurance companies to make mistakes. In a split decision, the majority declined to express any disdain for the bad faith “set-up.”²³ The high court proclaimed: “[T]he focus . . . is not on the actions of the claimant but rather on those of the insurer in fulfilling its obligations to the insured.”²⁴

Supreme Court Justice Wells dissented with an opinion to express his “substantial concern” about the effect of the majority’s decision. Similar to the special concurrence of Justice Alderman in 1980, Justice Wells warned:

[T]here are strategies which have developed in the pursuit of insurance claims which are employed to create bad faith claims against insurers when, after an objective, advised view of the insurer’s claims handling, bad faith did not occur. . . . The goal of this strategy is to convert a policy purchased by the insured which has low limits of insurance into unlimited insurance coverage.

* * *

Perpetuating this kind of bad faith action is not only wrong on the basis of the claims handling facts in this particular case, but is greatly detrimental to Florida’s liability insurance consumers because of the increases in their insurance costs.

* * *

The Court should recognize that it has the responsibility to reserve bad faith damages,

which is limitless, court-created insurance, to egregious circumstances of delay and bad faith acts.²⁵

The majority dismissed Justice Wells' concerns as inconsistent with its paramount interest of influencing claim-handling by the insurance industry:

In his dissent, Justice Wells has not cited any empirical data showing that since our decision in *Gutierrez*, there has been a direct correlation between bad faith claims and increased premiums. To the contrary, it is far more likely that the insurer's knowledge of the potential consequences of placing its own interests over that of its insured has a beneficial effect on the handling of claims.²⁶

It is beyond any reasonable debate that this ruling had the intended effect of influencing insurance company behavior. The Supreme Court of Florida effectively knighted the plaintiffs' bar in the quest to force self-regulation by insurance companies in the handling of claims. Now, insurance companies are not only subject to oversight by Florida's insurance commissioner, legislature and judiciary, but also by the trial lawyers that represent both first- and third-party claimants. However, Florida's high court could have done more. It could have reigned in the legal practice of "insurance claims by ambush" instead of allowing the bad faith "set up" to continue unabated.

VII. Loss Of Protection – A Piercing Blow And Biting Rhetoric

"Grandmother, what big teeth you have!"

In 2005, the Supreme Court of Florida issued another blow to insurance companies, by broadening the scope of discovery in first-party bad faith actions.²⁷ The Supreme Court declared the claim, investigation, and litigation files of an insurance company to be subject to production even if the materials were considered to be litigation work product. Until this decision, the Supreme Court of Florida had recognized the adversarial relationship between an insurer and its insured in a first-party coverage action.²⁸ This had been viewed as very different from the fiduciary relationship appurtenant to a third-party liability situation where the insurance company had taken over control of settlement decisions on behalf of its insured. The modern view

of Florida's first-party relationship of an insurer with its insured is now drastically changed.

The Supreme Court stated:

Today . . . we reconsider the wisdom of our decision in *Kujawa* and a fresh look at such decision convinces us that any distinction between first- and third-party bad faith actions with regard to discovery purposes is unjustified and without support under section 624.155 and creates an overly formalistic distinction between substantively identical claims.

* * *

The Legislature has clearly chosen to impose on insurance companies a duty to use good faith and fair dealing in processing and litigating the claims of their own insureds as insurers have in dealing with third-party claims. Thus, there is no basis to apply different discovery rules to the substantively identical causes of action.²⁹

Giving teeth to this new "wisdom," the Supreme Court of Florida issued its new mandate:

[A]ll materials, including documents, memoranda, and letters, contained in the underlying claim and related litigation file material that was created up to and including the date of resolution of the underlying disputed matter and pertain in any way to coverage, benefits, liability, or damages, should also be produced in a first-party bad faith action.³⁰

Notably, the production of claim and litigation materials through the resolution of the underlying coverage dispute is required, without any showing of good cause. The court was apparently persuaded by the argument that the claim and litigation files are the best and only evidence of an insurer's "good faith" or "bad faith" handling of a claim brought by its own insured.³¹ In addition, similar materials prepared *after* the resolution of the underlying disputed matter could be discoverable upon a showing of good cause.³²

The Supreme Court admonished parties in future litigation not to shield any documents that pertain to the

processing or litigation of the underlying claim, by asserting that such documents were prepared in anticipation of litigation of the bad faith action.³³ The Supreme Court's disdain for any attempt to protect documents that previously were entitled to work-product immunity was clear.

Most recently, in 2011, the Supreme Court of Florida rejected an argument that discovery in first-party bad faith actions requires disclosure of attorney-client privileged communications.³⁴ Before celebrating this success, however, insurers may want to consider the discussion in this decision with some trepidation. The Supreme Court of Florida recognized that it was not empowered to circumvent the attorney-client privilege protection codified by the legislature, but it also presented an extensive guide for trial courts on how to identify attorney-client communications that may be discoverable:

Although we conclude that the attorney-client privilege applies, we recognize that cases may arise where an insurer has hired an attorney to both investigate the underlying claim *and* render legal advice. Thus, the materials requested by the opposing party may implicate both the work product doctrine and the attorney-client privilege. Where a claim of privilege is asserted, the trial court should conduct an in-camera inspection to determine whether the sought-after materials are truly protected by the attorney-client privilege. If the trial court determines that the investigation performed by the attorney resulted in the preparation of materials that are required to be disclosed pursuant to *Ruiz* and did not involve the rendering of legal advice, then that material is discoverable.

Moreover, our opinion in this case is not intended to undermine any statutory or judicially created waiver or exception to the privilege. Specifically, we note that under the "at issue" doctrine, the discovery of attorney-client privileged communications between an insurer and its counsel is permitted where the insurer raises the advice of its counsel as a defense in the action and the communication is necessary to establish the defense.³⁵

Ultimately, while protecting communications that involve the rendering of legal advice, the Supreme Court of Florida presented a virtual road map for the lower courts to circumvent attorney-client privilege assertions where appropriate.

Justice Pariente specially concurred with an opinion. Her concurrence expresses regret that the judiciary does not have the power to do away with the attorney-client privilege between insurance companies and their attorneys.³⁶ Her opinion reiterates that where an insurer utilizes an attorney to investigate or evaluate the underlying claim and not to render legal advice, attorney-client privilege does not apply.³⁷

Read broadly, this commentary by Justice Pariente could be interpreted to allow disclosure of communications with counsel retained to assist in evaluating whether or not to pay policy benefits to avert extracontractual liability. Extra-contractual legal counsel routinely provide an analysis of the underlying claim in order to offer sound risk management recommendations to the insurance company.³⁸ Presumably, the Supreme Court does not intend to declare such communications to be discoverable in the absence of an "advice of counsel" defense raised by the insurer. However, with the Supreme Court of Florida's apparent vision that insureds should be given a more transparent view of the insurer's claim handling and decision-making in a bad faith action, more challenges to attorney-client privileges are inevitable. Insurers should expect first- and third-party claimants to seize on this opinion like a pack of wolves.

VIII. Conclusion

Insurers beware the ravaging wolves. The development of insurance "bad faith" law in Florida has reached its maturity. Be particularly vigilant because the courts continue to express their view that insureds are in need of greater protection, and will bring to bear the full measure of their influence to affect insurance company behavior.

Endnotes

1. Charles Perrault, "*Little Red Riding Hood*", translated and/or edited by D.L. Ashliman, © 1999-2011. Retrieved from www.pitt.edu/~dash/type0333.html (November 28, 2011).

2. Auto Mut. Indemnity Co. v. Shaw, 184 So. 852, 857 (Fla. 1938).
3. State Farm Mut. Auto. Ins. Co. v. Laforet, 658 So. 2d 55, 58 (Fla. 1995).
4. *Id.*
5. *Id.*, citing Baxter v. Royal Indem. Co., 285 So. 2d 652 (Fla. 1st DCA 1973), *cert. discharged*, 317 So. 2d 725 (Fla. 1975).
6. *Id.*, citing Roger C. Henderson, "The Tort of Bad Faith in First-Party Insurance Transaction: Refining the Standard of Culpability and Reformulating the Remedies By Statute" 26 U.Mich.J.L.Ref. 1, 21-22 (Fall 1992).
7. *Id.*
8. Shaw, 184 So. at 859.
9. Thompson v. Commercial Union Ins. Co. of New York, 250 So. 2d 259 (Fla. 1971).
10. *Id.* at 263.
11. 386 So. 2d 783 (Fla. 1980).
12. *Id.* at 785.
13. *Id.*, citing Campbell v. Government Employees Ins. Co., 306 So. 2d 525 (Fla. 1974).
14. *Id.* (citations omitted)("Because the duty of good faith involves diligence and care in the investigation and evaluation of the claim against the insured, negligence is relevant to the question of good faith").
15. Alan J. Nisberg, "Florida's Bad Faith Quagmire: Is Summary Judgment Ever Available?", Mealey's Litigation Report: Insurer Bad Faith, Vol. 22, #22 (March 26, 2009).
16. Gutierrez, 386 So. 2d at 786.
17. *Id.* (Alderman, Justice, concurring specially).
18. Magnifying the impact of this decision, one of Florida's intermediate appellate courts held that, under certain circumstances, liability insurers are required to initiate settlement negotiations, even without a demand from the claimant. See Powell v. Prudential Property & Cas. Ins. Co., 584 So. 2d 12 (Fla. 3d DCA 1991). This oft-cited holding resulted in a significant expansion of the responsibilities of insurers handling third-party claims. See generally James Michael Shaw, Jr., "(Almost) 20 Years After Powell: Case Studies On A Liability Insurer's Duty To Initiate Settlement Negotiations," Mealey's Litigation Report: Insurance Bad Faith, Vol. 24, #1 (May 13, 2010). Contrary to the law of almost every other jurisdiction in the country, a third-party bad faith lawsuit in Florida does not require there to be a settlement demand which the insurer failed to capitalize on to prove bad faith. *Id.* This resulted in claimants and their legal counsel withholding demands, failing to respond to insurance adjusters who were attempting to investigate and possibly settle claims, and more accident and extra-contractual lawsuits.
19. LaForet, 658 So. 2d at 59.
20. Macola v. GEICO, 953 So. 2d 451 (Fla. 2006), quoting Allstate Indemnity Co. v. Ruiz, 899 So. 2d 1121, 1124 (Fla. 2005).
21. Opperman v. Nationwide Mut. Fire Ins. Co., 515 So. 2d 263, 265 (Fla. 5th DCA 1987); Saenz v. Campos, 967 So. 2d 1114, 1117 (Fla. 4th DCA 2007).
22. See Fla. Stat. § 624.155(8).
23. Berges v. Infinity ins. Co., 896 So. 2d 665 (Fla. 2004) rehearing denied (2005). Chief Justice Pariente wrote the opinion of the Court in which Justices Anstead, Lewis and Quince concurred. Justices Wells, Cantero and Bell dissented.
24. Berges, 896 So. 2d at 677.
25. Berges, 896 So. 2d at 685-86.
26. Berges, 896 So. 2d at 683.
27. Allstate Indemnity Co. v. Ruiz, 899 So. 2d 1121 (Fla. 2005).
28. Manhattan National Life Ins. Co. v. Kujawa, 522 So. 2d 1078 (Fla. 4th DCA 1988), approved, 541 So. 2d 1168 (Fla. 1989).

29. Ruiz, 899 So. 2d at 1128 (citations omitted).
30. *Id.* at 1129-30.
31. Ruiz, 899 So. 2d at 1124 (“As the insureds succinctly posit, how is one to ever determine whether an insurance company has processed, analyzed, or litigated a claim in a fair, forthright, and good faith manner if access is totally denied to the underlying file materials that reflect how the matter was processed and contain the direct evidence of whether the claim was processed in ‘good’ or ‘bad’ faith?”).
32. *Id.* at 1130.
33. *Id.*
34. *Genovese v. Provident Life and Accident Ins. Co.*, So. 3d, 2011 WL 903988 (Fla. March 17, 2011), 36 Fla. L. Weekly S97.
35. *Id.*
36. *Id.* at *5 (“While we strived in *Ruiz* to level the playing field in the critical area of discovery between first- and third-party bad faith cases, we must acknowledge that we do not have the independent authority to abrogate the statutory attorney-client privilege, even in the context of bad faith claims”).
37. *Id.*
38. In fact, Florida Statutes § 624.155(3)(a) requires, as a condition precedent to bringing a first-party bad faith action, both the insurer and Florida’s Department of Financial Services must be given sixty days written notice of alleged bad faith misconduct. If this sixty-day notice is provided while the underlying claim is still open, then the insurer will often seek the assistance of qualified extra-contractual legal counsel to respond to the civil remedy notice. Section 624.155(3)(d) precludes a first-party action for bad faith if the damages are paid or the circumstances giving rise to the violation are corrected. If the insurer pays policy limits within sixty days after the notice is filed, then a first-party bad faith lawsuit can be avoided. Therefore, insurers almost always seek a recommendation from their extra-contractual legal counsel as to whether or not to pay policy limits within that sixty-day safe harbor period. Such a recommendation clearly implicates legal counsel’s “evaluation of the underlying claim.” ■

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