MEALEY'S LITIGATION REPORT

# Insurance Bad Faith

## Bad Faith — Variations On A Theme

*by*
*Julius 'Rick' Parker III, Esq.*

*Butler Pappas Weihmuller Katz Craig LLP*
*Tallahassee, Florida*

**A commentary article reprinted from the July 29, 2010 issue of Mealey's Litigation Report: Insurance Bad Faith**

# Commentary

## Bad Faith — Variations On A Theme

By
Julius F. 'Rick' Parker III

*[Editor's Note: Julius F. "Rick" Parker III is a senior associate with the law firm of Butler Pappas Weihmuller Katz Craig LLP with offices in Charlotte, Chicago, Miami, Mobile, Tallahassee, and Tampa. Mr. Parker is an experienced trial lawyer in the firm's Third-Party Coverage and Extra-Contractual Departments. Any commentary or opinions do not reflect the opinions of Butler Pappas or Mealey's Publications.*  *Responses are welcome.]*

The creativity of a plaintiff's attorney seeking to create a deep pocket from which to recover for his client's significant injuries can never be underestimated. Beginning in the 1970's, courts began to expand the "tort" of third-party bad faith, with the result that many insurers found themselves providing "coverage" for liability incurred by their insureds without any limit whatsoever. Like any industry in which a revolutionary innovation is introduced, the bad-faith industry rapidly expanded in the early days. For many plaintiffs' attorneys, the pickings were easy, as many insurers had not yet had time to assimilate the new law into their claims-handling processes. However, also like any new innovation, after the early, rapid expansion, increases in bad-faith claims flattened out as insurers "caught up" to the set-ups created by the plaintiffs' bar. As a result, new variations on the old theme of third-party bad faith had to be created. This article examines some of the more creative theories, the logic behind them, and reasons for rejecting them.

### The Original Theme

The original theme is familiar. Plaintiff is injured severely by an insured holding a minimum-limits liability policy. Plaintiff's counsel offers to settle his client's claim upon payment of the policy limits in a short time frame. The insurer either rejects the demand or makes a counter-offer, at which time the demand is withdrawn and the plaintiff proceeds to obtain a large judgment for which the insurer is liable, due to its failure to protect its insured's interests. This scenario is easy to detect and most insurers have taken measures to ensure that claims with this fact pattern are found early and given close scrutiny.[1]

### Variation 1 — Punitive Damages

The first variation really involves a manufacturing of coverage which does not exist. In this scenario, the severely injured plaintiff is hurt by an insured with plenty of coverage, enough in fact to satisfy the full value of the claim. Once the case is filed, the plaintiff adds a claim for punitive damages (in a state in which such damages are uninsurable or where the policy itself excludes such coverage). Presume, for example, that the insured has $1,000,000 in coverage and the "full value" of the plaintiff's compensatory claim is $500,000. So the plaintiff adds a claim for punitive damages. Ordinarily, the insurer would be safe in assuming that it need not concern itself with protecting its insured against the punitive-damage claim, since it is not covered in the first place. Unfortunately, that assumption is often incorrect.

Savvy plaintiffs' attorneys recognized that the insurer is required to defend both covered and non-covered claims when they are asserted in the same lawsuit. Therefore, the insurer still must provide a defense against punitive damages despite the fact that they are clearly excluded from coverage. So far so good. But this duty can be distorted to the point that, in order to avoid a finding of bad faith, the insurer must consider paying more than the full compensatory value of the claim in order to protect its insured against an excess judgment notwithstanding that the punitive claim is inarguably not covered.

A prime example of this variation is *Ging v. American Liberty Insurance Co.,*[2] a federal case interpreting Florida law. *Ging* held that, even though a claim for punitive damages is not covered under a liability policy, the insurer has a duty to act in good faith *vis a vis* the insured with regard to those damages. The language of the opinion is loose, leaving much to later interpretation:

> It is not necessary for us to decide — and we do not decide — whether the policy imposed a duty on the insurer to defend against a claim for punitive damages when it was joined with a claim for compensatory damages. It is sufficient for the purposes of the case at bar to hold that once having undertaken the defense of a non-covered claim, the insurance company is under an obligation to act in good faith toward its insured to the entire extent of its undertaking.

This raises the obvious question: does the duty of good faith extend to actually paying too much on the compensatory claim in order to protect the insured from the punitive claim? If the answer is "Yes," the plaintiff has manufactured coverage which never existed.

The *Ging* rationale, however, has not met with much success and for good reason.[3] If the insurer's duty to defend encompasses a duty to pay on an uncovered claim, then the duty to defend must be equated with the duty to indemnify, a proposition that has never seen the light of day. It is generally held that an insurer's duty to defend is far broader than the duty to indemnify.[4] If any of the claims in the complaint allege covered damages, then the insurer must defend the entire complaint. If the duty to indemnify is extended as broadly as the duty to defend, then exclusions are meaningless and all claims are covered. That bedrock principle is what has likely kept Variation 1 in check. Thus, what appeared to be a clever way to manufacture coverage has simply not materialized as the plaintiff's bar hoped it would.

### Variation 2 — Multiple Claimants

The second variation is very similar to the classic theme. The insured, covered by a single limit policy, causes an accident and in the process injures more than one person. As a result, both claimants demand the single limit of coverage. The insurer is thus presented with a "Catch-22", to-wit, pay the limits to one claimant, leaving the other claimant with nothing (and face resulting bad-faith liability), or attempt to divide the limits between the claimants, also creating potential bad faith liability.

Fortunately, courts have recognized the unfairness of imposing bad-faith liability on an insurer in this situation, and generally allowed the insurer the discretion to settle claims among multiple claimants as it sees fit without incurring bad-faith liability.[5] However, an insurer walks a fine line when attempting to settle as many claims as possible with low limits, as many courts view the question of whether the insurer indiscriminately settled cases in order to exhaust its limits and thereby terminate its duty to defend as one of fact for a jury. The moment the question of bad faith is deemed one of fact, bad faith liability will not be far behind. So long as a plaintiff can survive a motion to dismiss a bad-faith claim, the chances of obtaining a settlement in excess of policy limits will be very high indeed. Thus, Variation 2 requires special attention and must be handled as carefully as the opening theme.

### Variation 3 — Multiple Insureds

Variation 3 is similar to Variation 2. In this scenario, however, there is only one claimant, but more than one insured who is potentially liable for the claimant's injuries. The classic example is where the claimant is injured by a permissive user of the named insured's automobile. In that situation, most auto policies confer additional-insured status on the permissive user. Alternatively, the named insured can be the permissive user with the vehicle's owner being an additional insured under an "omnibus insured" provision. Either way, the insurer must attempt to extinguish the liability of both of its insureds in order to avoid bad-faith liability.

An excellent example of this situation is *Contreras v. U.S. Security Insurance Co.*[6] In *Contreras*, the claimant offered to provide a full release of liability to one insured in exchange for the full policy limit, but refused to release the other insured. This scenario is not uncommon, particularly where one insured appears to have assets beyond coverage. Thus, another "Catch-22" is presented: should the insurer do what it can to protect one insured and face a bad faith claim from the other insured who is left exposed, or insist on a release of both insureds and face a bad faith suit by both insureds?[7]

The *Contreras* court recognized the unfairness of allowing this kind of set-up to result in bad faith liability, explaining:

> Having attempted to secure a release for Dale without success, U.S. Security fulfilled its obligation of good faith towards Dale. Once it became clear that Contreras was unwilling to settle with Dale and give him a complete release, U.S. Security had no further opportunity to give fair consideration to a reasonable settlement offer for Dale. Since U.S. Security could not force Contreras to settle and release Dale, it did all it could do to avoid excess exposure to Dale.[8]

Thus, Variation 3 finds no purchase and fizzles as a means of manufacturing coverage as well.

### Variation 4 — Multiple Claimants With Varying Damages

Variation 4 is really a variation on Variation 2. In this scenario, the insured causes an accident which results in injuries to several claimants, but the extent of their injuries varies greatly. One claimant's damages clearly exceed the "per person" limit of liability, but the other claimants' do not. Therefore, the plaintiffs' attorney makes a demand for the full "per accident" or "per occurrence" limits of liability in return for a release of claims of all claimants.

To illustrate, presume that the policy provides limits of $100,000 per person/$300,000 per accident. Claimant A's injuries are valued at $300,000, but claimant B and C's injuries are valued at only $50,000 each. Does the insurer have a duty to accept the offer, in essence overpaying for two claims, in order to avoid an excess exposure on the third claim?

Very few courts have addressed this issue. However, it has generally been rejected as a means of creating bad faith liability. *See Redcross v. Aetna Casualty & Surety Co.;*[9] *Rosell v. Farmers Texas County Mutual Insurance Co.;*[10] *Clark v. Hartford Accident & Indemnity Co.*[11] The *Redcross* court rejected that attempted set-up outright, stating:

> [A]n insurer confronted with multiple claims arising out of the same accident is not required — in order to forestall a bad-faith settlement claim — to accept a "package deal" within the overall policy limits if, in doing so, it would be overpaying on some of the claims in order that in the other claims, as to which the insurer is ready to pay the full policy limit, the insured not be exposed to liability that exceeds the policy limit.[12]

Both the Texas and Tennessee appellate courts which ruled on the issue also rejected this attempted set-up.[13] Thus, the unanimous opinion of courts on this issue is that it fails.

### Variation 5 — Multiple Coverages

Variation 5 appears to be the newest and least-tested theory. It involves a policy which provides both bodily injury and property damage coverage, both with minimal limits. The insured causes an accident which results in significant bodily injury damages, but property damage slightly above the limit for that coverage. For example, each coverage has a limit of $10,000 and the bodily injury claim is valued at $200,000, but the property damage claim is initially valued at $9,000. The insurer tenders the bodily injury limit immediately, but negotiates the property damage claim rather than accepting a demand for the limits of coverage. When later evidence shows the property damage claim to be worth more than $10,000, the insurer then tenders the limit of property damage coverage and the claimant refuses, claiming the insurer is in bad faith.

The question is whether the insurer's bad faith in connection with the property damage claim opens the limit of liability for the bodily injury claim, since both coverages are found in the same policy. It appears for now that a California court of appeals is the only court in the nation to have addressed this novel theory, and its decision is cause for concern. *See Hutton v. Mercury Casualty Co.*[14]

In *Hutton*, the insured caused an accident which resulted in the total loss of Hutton's 1968 Volkswagen, as well as severe bodily injuries. In adjusting the claim, the insurer's claim professional refused a combined demand for the limits of the insured's bodily injury coverage ($15,000) and $2,600 for the Volkswagen. The insured had a $10,000 limit for property damage. The claim professional refused the offer because the Volkswagen was only worth $2,400.

The claimant then sued the insured and obtained a verdict of $3,500,000. The insurer paid $500,000 and agreed to pay the remainder in the event Hutton succeeded on a bad faith claim. The California court rejected the insurer's contention that tying the settlement of the bodily injury claim to acceptance of an inflated property damage demand made the demand unreasonable as a matter of law (thereby vitiating bad faith). The court instead upheld the jury's finding that the insurer's rejection of the demand was unreasonable. Curiously, the court did not explicitly consider the question of whether the bad faith in connection with the property damage coverage resulted in a waiver of the bodily injury limits. Rather, the court appears simply to have assumed that it did.

*Hutton* is very difficult to reconcile with the decisions concerning Variation 4. Those opinions clearly reject the idea that "per person" limits are irrelevant in the context of multiple claimants <u>within the same coverage</u>. If an insurer is not required to overpay on one claim in order to settle a separate claim under the same coverage, it is difficult if not impossible to justify tying the bodily injury and property damage coverages to a single act of bad faith. Perhaps that explains why *Hutton* has not gained any widespread acceptance.

From a logical standpoint, the rationale of *Hutton* also runs contrary to other well-established principles of law. For example, each coverage for which a separate premium is charged generally constitutes a separate contract of insurance, the breach of which gives rise to a separate cause of action.[15] Therefore, logically, bad faith in connection with a property damage claim should have no impact on the separate contract of insurance for bodily injury.

Conversely, where the <u>insured</u> commits fraud in connection with one coverage under a policy, that fraud does not vitiate other coverages under the policy.[16] Thus, where the insured's actions result in a loss of coverage, that act has no effect on a separately stated coverage in the same policy. Justice demands that the insurer receive comparable treatment. There is no logical reason why the separate coverage rule should not apply regardless of which party has breached the separate coverage. If the coverages are separate contracts, bad faith in connection with one could not possibly have any effect on the other.

## Conclusion

Generally, courts get it right. The *Hutton* court, whether by design or omission, did not. Creative attempts at manufacturing coverage have generally been met with disfavor as evidenced by the general rejection of Variations 1 through 4. The *Hutton* court simply got it wrong. However, in the six years since the opinion was released, it has not been followed. Therefore, *Hutton* will likely gather dust and take its rightful place on the shelf with the other unsuccessful variations on the bad faith theme. The only question left is "What is the next Variation?"

---

## Endnotes

1. Most examples of the various scenarios presented herein are taken from Florida law, where this writer practices. Not all states have considered all of these variations. However, their treatment in Florida courts generally presents the prevailing arguments for and against imposing extra-contractual liability in these instances.

2. 423 F.2d 115 (5th Cir. 1970).

3. *See, e.g.,* Rodriguez v. Am. Ambassador Cas. Co., 4 F.Supp. 2d 1153 (M.D. Fla. 1998)(rejecting argument that *Ging* required insurer to accept offer of inflated property damage claim to protect insured against substantial bodily injury claim where policy provided no bodily injury coverage); Calhoon v. Leader Specialty Ins. Co., 2007 WL 4098840 (M.D. Fla. Nov. 15, 2007) (same). *But see* Allstate Indemnity Co. v. Oser, 893 So. 2d 675 (Fla. 1st DCA 2005) (relying on *Ging* to find insurer undertook duty to protect

insured against bodily injury claim by accepting demand for limits of property damage coverage despite fact that policy provided no bodily injury coverage).

4. *See, e.g.*, Jones v. Fla. Ins. Guaranty Ass'n, 908 So. 2d 435, 443 (Fla. 2003).

5. *See* Farinas v. Fla. Farm Bureau Gen. Ins. Co., 850 So. 2d 555 (Fla. 4th DCA 2003).

6. 927 So. 2d 16 (Fla. 4th DCA 2006).

7. Technically, the bad faith suit would be brought by the claimant, and/or the insureds.

8. Id., 927 So. 2d at 21.

9. 260 A.D.2d 908 (N.Y. Ct. App. 1999).

10. 642 S.W.2d 278 (Tex. Ct. App. 1982).

11. 457 S.W.2d 35 (Tenn. Ct. App. 1970).

12. Recross, 260 A.D.2d at 911.

13. *See* Rosell v. Farmers Texas County Mut. Ins. Co. 642 S.W.2d 278 (Tex. Ct. App. 1982); Clark v. Hartford Accident & Indemnity Co., 457 S.W.2d 36 (Tenn. Ct. App. 1970).

14. 2004 WL 1467442 (Cal. Ct. App. 4th Dist. June 30, 2004).

15. *See* Bryant v. Allstate Ins. Co., 584 So. 2d 194 (Fla. 5th DCA 1991); Almeroth v. Gov't Employees Ins. Co., 587 So. 2d 550 (Fla. 4th DCA 1991); State Farm Mut. Auto. Ins. Co. v. Yenke, 804 So. 2d 429 (Fla. 5th DCA 2002).

16. *See* Flores v. Allstate Ins. Co., 819 So. 2d 740 (Fla. 2002); *Cf.* Bosem v. Commerce & Industry Ins. Co., --- So. 3d ---, 2010 WL 1565553 (Fla. 3d DCA 2010) (holding that fraud in connection with PIP claim for lost wages voided all coverage under policy for PIP claim for medical bills; these coverages all fall within PIP coverage). ■

**MEALEY'S LITIGATION REPORT: INSURANCE BAD FAITH**
*edited by Mark Rogers*
**The Report** is produced twice monthly by

LexisNexis

1018 West Ninth Avenue, 3rd Floor, King of Prussia Pa 19406, USA
Telephone: (610) 768-7800 1-800-MEALEYS (1-800-632-5397)
Fax: (610) 962-4991
Email: mealeyinfo@lexisnexis.com Web site: http://www.lexisnexis.com/mealeys
ISSN 1526-0267