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ESTABLISHING GOOD FAITH IN A WORLD OF BAD FAITH

December 10, 2024

PRESENTERS

Kristian Moriarty
Partner
HAIGHT BROWN & BONESTEEL, LLP
Los Angeles, CA
kmoriarty@hbblaw.com
(213) 542-8000

Todd McCormack
Vice President, Senior Legal Counsel
W.R. BERKLEY CORP.
New York, NY
tmccormack@wrberkley.com
(203) 542-3553

Reed Grimm
Shareholder
TAYLOR, DAY, GRIMM & BOYD
Jacksonville, FL
rwg@taylordaylaw.com
(904) 356-3224

Richard Hennessey
Partner
MORRISON MAHONEY, LLP
Boston, MA
rhennessey@morrisonmahoney.com
(617) 670-8913

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“BAD FAITH” GENERALLY

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General Principles of Bad Faith

- In the 1980s, the common-law basis for the tort of bad faith in the first-party context was adopted and expanded in a majority of states.
- Generally speaking, an insurer can be said to be acting in bad faith by purposely failing to investigate a claim, concealing contractual language, slow-walking settlement negotiations, or depriving an insured (or a third-party in many states) of policy benefits owed
- Most jurisdictions require some element of intentional conduct on the part of an insurer – i.e. the insurer must act *knowingly*, *unreasonably*, *or* with such *reckless disregard* that knowledge of policy benefits deprivation can be imputed to it

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The Balance of Interests

- Insured's Right to Policy Benefits versus Insurer's Rights to Enforce Policy Terms
- In a famous California Supreme Court decision, one dissenting Justice pointed out: "[I]t seems to me that attorneys who handle policy claims against insurance companies are no longer interested in collecting on those claims, but spend their wits and energies trying to maneuver the insurers into committing acts which the insureds can later trot out as evidence of bad faith." *White v. Western Title Ins. Co.*, 40 Cal.3d 870, 900-901 (1985) (Justice Kaus Dissenting Opinion)

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Balance of Interests – Attorneys' Fees

- To balance the interests, most jurisdictions approach bad faith from a remedies standpoint:
- Attorneys' Fees
  - California, for example, permits the recovery of attorneys' fees expended by an insured who successfully establishes bad faith of an insurer. *Brandt v. Superior Court*, 37 Cal.3d 813,817 (1985).
  - New York rejected this rule in *Samovar of Russia Jewelry Antique Corp. v. Generali the General Ins. Co. of Trieste and Venice*, 102 A.D.2d 279, 284 (1984)

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Balance of Interests – Emotional Distress

- Some States Permit Recovery for an insured's emotional distress: "The tort of bad faith had as its genesis the very idea of providing a plaintiff who had been victimized by the intentional, wrongful handling of a claim by the insurer, the right to recover not only contract damages but for the loss occasioned by emotional suffering, humiliation, and embarrassment …." *Aetna Life Ins. Co. v. Lavoie*, 470 So. 2d 1060, 1073--74 (Ala. 1984)
- Other States have rejected such recovery: See *Southern General Ins. Co. v. Holt*, 262 Ga. 267 (1992)

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Balance of Interests - Punitive Damages

- *Most* States permit the recovery of punitive damages upon a heightened standard -- typically a showing of malice, willfulness, or wanton disregard for the rights of the insured. *Intercontinental Life Ins. Co. v. Lindblom*, 598 So. 2d 886, 890 (Ala. 1992)
- However, some states do not: Maryland's statutory scheme does *not* permit recovery of punitive damages against an insurer for bad faith on first party claims. See MD CTS & JUD PRO Section 3-1701

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COMMON LAW VERSUS STATUTORY “BAD FAITH”

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Statutory Versus Common Law “Bad Faith”

- Every State in the Country authorizes either common law or statutory “bad faith” claims in some sense
- First Party versus Third Party Claims
- Statutory versus common law
- Statute of Limitations Issues are very State-specific

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Example of Statutory First Party Bad Faith

- Maryland, for example, has codified “bad faith” claims in its statutory scheme at MD CTS & JUD PRO Section 3-1701:

(e) Notwithstanding any other provision of law, if the trier of fact in an action under this section finds in favor of the insured and finds that the insurer failed to **act** in good faith, the insured may recover from the insurer:

(1) Actual damages, which actual damages may not exceed the limits of the applicable policy;

(2) Expenses and litigation costs incurred by the insured in an action under this section or under § 27-1001 of the Insurance Article or both, including reasonable attorney's fees; and

(3) Interest on all actual damages, expenses, and litigation costs incurred by the insured, computed:

(i) At the rate allowed under § 11-107(a) of this article; and

(ii) From the date on which the insured's claim would have been paid if the insurer **acted** in good faith.

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Examples of Common Law Bad Faith States

- California, New Jersey, New York, and many other states have no statutes expressly creating a cause of action for bad faith – but the case law has developed the rules and standards for same.
- An insurer's duty is unconditional and independent of the performance of the insured's contractual obligations. An insurer also acts in bad faith when it fails to act reasonably in processing and handling a claim. See *Egan v. Mutual of Omaha Ins. Co.*, 598 P.2d 452 (1979) (An insurer also commits bad faith by failing to promptly investigate a claim). See *Richardson v. Employers Liability Assurance Co.*, 25 Cal. App. 3d 232, 245 (1972) (An insurer acts in bad faith when it knows there is coverage, but denies the claim anyway).

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“FAIRLY DEBATABLE,” “GENUINE DISPUTE,” AND OTHER MEANS OF ESTABLISHING *GOOD* FAITH

“Genuine Dispute” / “Fairly Debatable” / “Arguable Basis” / “Legitimate Dispute”

- Most States recognize a complete or partial defense to “bad faith” claims when the decision to deny coverage was either “Fairly Debatable,” there exists a “Genuine Dispute” of coverage, or where there was an “Arguable Basis” for a coverage denial
  - New York applies the “Arguable Basis” standard
  - California applies the “Genuine Dispute” doctrine
  - Alabama, Arizona, Colorado, Kentucky, Mississippi, Montana, Iowa, Idaho, North Dakota, Rhode Island, New Jersey, South Carolina, Utah, Virginia, Wisconsin, Wyoming apply the “Fairly Debatable” standard
  - Ohio and Oklahoma have adopted a “”Legitimate Dispute” or “reasonable Justification” standard

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Burden of Proof

- Who bears the burden of proof also varies by state.
  - Burden on the Insurer – California treats the “Genuine Dispute” doctrine as an affirmative defense
  - Burden on the Insured – Idaho and New Jersey, for example, treat the issue as part of the Plaintiff’s prima facie case

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Pop-Up Question

- **Who Bears the Burden of Proof in establishing an insurer's decision was "Fairly Debatable," or that there existed a "Genuine Dispute?"**

A. The Insured

B. The Insurer

C. It depends on the jurisdiction

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Common Factors Considered

- While the factors and tests vary by State, these are common considerations that affect the application of the doctrines:
  - Did the Insurer exercise reasonable care in the investigation of the claim?
  - Is the basis for the insurer's decision a dispute of *fact* or *law*?
  - Is this a first-party claim or a third-party claim?
  - "Failure to settle" versus "denial of coverage"?
  - "Duty to Defend" versus "Duty to Indemnify"?

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“ADVICE OF COUNSEL”

The Advice of Counsel as a Defense to Bad Faith Claims

- Many States recognize a defense to “Bad Faith” claims when the carrier relied on the “Advice of Counsel” in making its coverage determination.
- Insurer must waive the attorney-client privilege and produce pertinent documents relied upon
- While many states require the defense to be pleaded in an initial Answer, a party can usually amend their Answer to assert the defense, but must do so understanding the attorney-client privilege is effectively waived as to the relied upon advice.

Advice of Counsel Defense *cont.*

- An insurer intending to rely upon the defense must/should hire *separate counsel* to defend the "bad faith" suit
- Seek a protective order governing the produced attorney-client privileged documents

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Advice of Counsel Defense - Standards

- While this defense also has state specific nuances, it generally requires an insurer to plead and prove:
  - (1) the insurer acted in reliance on the opinion and advice of its lawyer;
  - (2) The lawyer's advice was based on full disclosure by the insurer of all relevant facts that it knew, or could have discovered with reasonable effort;
  - (3) The insurer reasonably believed the advice of the lawyer was correct;
  - (4) In relying on its lawyer's advice, the insurer gave at least as much consideration to the insured's interest as it gave its own interest; and
  - (5) The Insurer was willing to reconsider and act accordingly when it determined that the lawyer's advice was incorrect.

(See California Civil Jury Instructions (CACI 2335 – Bad Faith – Advice of Counsel)

QUESTIONS?

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THANK YOU! If you have any questions, please feel free to reach out to any of the panelists!

Kristian Moriarty
Partner
HAIGHT BROWN & BONESTEEL, LLP
Los Angeles, CA
kmoriarty@hbblaw.com
(213) 542-8000

Todd McCormack
Vice President, Senior Legal Counsel
W.R. BERKLEY CORP.
New York, NY
tmccormack@wrberkley.com
(203) 542-3553

Reed Grimm
Shareholder
TAYLOR, DAY, GRIMM & BOYD
Jacksonville, FL
rwg@taylordaylaw.com
(904) 356-3224

Richard Hennessey
Partner
MORRISON MAHONEY, LLP
Boston, MA
rhennessey@morrisonmahoney.com
(617) 670-8913

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