Recent Developments in Bad Faith Claims

by Robert D. Chesler and Christina Yousef

States vary widely in the extent to which they credit policyholders' claims of bad faith in suits alleging wrongful conduct on the part of their insurance companies. In states that look with comparative favor on such claims, the threat of punitive damages or attorneys' fees gives policyholders vital leverage in insurance coverage disputes. As with many insurance coverage flashpoints, this issue is ground out state by state, and in some periods the wind blows decisively in one direction.

In three cases this past quarter, courts in New Jersey, Kansas and Illinois found that policyholders were entitled to extra-contractual relief because of their insurance companies' failures in dealing with their policyholders. In a fourth case, the Georgia Supreme Court will decide whether an insurance company's negligence in response to settlement overtures constitutes bad faith

A recent decision by the Third U.S. Circuit Court of Appeals, applying New Jersey law, is of particular interest to New Jersey policyholders. In *Alpizar-Fallas v. Favero*, the policyholder, insured by Progressive Garden State Insurance Company, was involved in a car accident. Allegedly, the Progressive claims-handler fraudulently induced the policyholder to enter into a release, which in fact released the other driver in the accident—who was also a Progressive policyholder.

The policyholder brought suit against Progressive under the New Jersey Consumer Fraud Act (CFA). The lower court dismissed her claim, holding that the CFA only applied to the sale or marketing of insurance policies. The Third Circuit reversed, finding that the law covers "fraud both in the initial sale (where the seller never intends to pay) and fraud in the subsequent performance (where the seller at some point elects not to fulfill its obligations)."

Alpizar-Fallas is a groundbreaking decision. The Consumer Fraud Act provides for an award of treble damages and attorneys' fees as remedies, providing policyholders with a potent weapon against bad faith behavior by insurance companies.

Another noteworthy case is *Gruber v. Marshall* from the United States District Court for the District of Kansas. There, the policyholder was awarded approximately $11.6 million on a $100,000 policy. The case involved an airplane crash resulting in the death of a passenger, and despite the policyholder's desire to settle the case early, the insurance company did not offer its policy limit of $100,000 for over a year. No coverage issues existed. The court found that had the insurance company offered its policy limit earlier, it would have protected the policyholder's estate from exposure to any further claims or suits brought by the victim's estate. As a result, the court found the insurance company liable for the entire verdict of $11.6 million.

The Appellate Court of Illinois also awarded extra-contractual damages in *Charter Properties Inc. v. Rockford Mutual Insurance Co.* The policyholder was an owner of a commercial building that partially collapsed. The policyholder submitted a claim to its insurance company for the loss of the building and lost business income. While the insurance company made some payments, the claims were ultimately "held in abeyance" until further inspection. The insurance company did not explain why it denied certain damages, did not complete the property inves-

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tigation, and failed to complete its liability determination. As a result, under the Illinois Insurance Code, the court awarded the policyholder, in addition to its damages, $27,692 for other costs, $48,784 for attorneys' fees, and $30,697 in statutory penalties.

In *First Acceptance Insurance Co. of Georgia Inc. v. Hughes*, the Georgia Supreme Court will decide whether (as in Gruber) an insurance company's failure to settle a case within policy limits rises to the level of bad faith. In this case, the policyholder caused a multi-car crash that killed him and hurt six others. Among the injured were a woman and her two-year-old daughter, who suffered traumatic brain injury. The woman's attorney sent two letters to First Acceptance, one expressing an interest in settling the claims within policy limits ($25,000 per person and $50,000 per accident) and the second requesting information about the policy within 30 days. First Acceptance failed to respond, allegedly due to a clerical error. The injured party sued and won a $5.3 million judgment. The administrator of the policyholder's estate sued First Acceptance, alleging bad faith in the failure to settle the claim. A trial judge granted summary judgment to First Acceptance, but the Georgia Court of Appeals revived the suit.

In the pending appeal, First Acceptance argued that there should be no liability for bad faith unless the plaintiff in the underlying suit made a "clear and valid" settlement offer, as opposed to a mere overture. More broadly, the suit tests whether alleged negligence—failure to respond due to a clerical error—can constitute bad faith. From a policyholder's point of view, a "no" answer might constitute an incentive to negligence in processing of claims.

The three recent rulings establish that policyholders in a significant number of states have potential recourse when insurance companies act badly. In every insurance coverage case, policyholders must consider whether they have facts that support a viable extra-contractual claim. With the added deterrent of punitive damages, insurance companies may think twice before unnecessarily denying or limiting claims. Should the Georgia Supreme Court rule for the policyholder in *First Acceptance*, insurance companies will also need to take warning that good faith does not permit negligence that costs their policyholders. ■

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