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Preventing and Defending Bad Faith Lawsuits

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Bad Faith in Context

Bad faith most commonly arises in one of three different contexts: (1) in a claim that an insured brings against its own insurer; (2) in a claim that a third-party makes against a policyholder that an insurer is asked to defend and indemnify; and (3) when a primary carrier is responsible for handling a claim that may involve an excess insurance carrier. Although each context presents different specific challenges and obligations which should be identified, managed, and complied with, there are concepts that apply to all bad faith litigation prevention and defense.

Identifying Bad Faith Actions

The first step in preventing and defending bad faith claims is to identify the actions that can reasonably lead to bad faith allegations. The following is a non-exhaustive list of actions that could be considered bad faith:

- Sending unlicensed or inexperienced adjusters to investigate the property/accident;
- Making an offer that is not within a reasonable valuation;
- Increasing/decreasing valuation or reserves without explanation;
- Reliance on untrustworthy experts or independent adjusters;
- Ignoring or refusing to consider expert or independent adjuster opinions;
- Unreasonably delaying review, failing to review, or refusing to consider available all available information;
- Requesting records more than once or requesting records without a basis;
- Evaluation based on inadmissible facts;
- Unreasonable interpretation of policy provisions/citing inapplicable provisions in position letter;
- Failing to issue payments on undisputed portions or coverage;
- Communicating with an insured directly after they hire legal counsel;
- Misrepresentation of fact or policy provisions; and,
- Delaying or refusing to communicate.

Along with identifying actions that could be considered bad faith, understanding what is not considered bad faith will assist in preventing and defending bad faith claim. The following is a non-exhaustive list of actions that are generally not considered bad faith:

- Requesting relevant documents or an examination under oath;
- Hiring a qualified and independent expert to provide an opinion regarding the claim;
- Coverage disputes relating to scope or pricing based on a reasonable interpretation of the policy applied to the facts of the claim;
- Refusing to make an offer in a frivolous suit or standing behind a coverage determination;
- Litigating a disputed claim;
- Involvement in discovery disputes; and,
- Asserting policy defenses where insured breaches the insurance contract, i.e., failed to cooperate, failed to provide prompt notice, material misrepresentation, etc.

Preventing Bad Faith Actions

It is important to consider (1) the proper practices for claim handling, (2) any new case law explaining or changing jurisdictional precedence for what actions can be considered bad faith, and (3) the significance of training and management to avoid these issues. The most effective tools for preventing a claim from inadvertently rising to the level of bad faith are proper documentation and prompt communication. When a file is documented thoroughly, there is less room for dispute or uncertainty as to the actions that have or have not been taken. For example, if an insured tells an adjuster where they were when a fire occurred during an initial site inspection and then subsequently changes their story, without proper documentation regarding what the insured said, it is the insured's word versus the adjuster's. Noting that information in the file at the time it is received creates a record that supports the adjuster's version of events. Documenting the file also allows claim handlers to review actions they have already taken to ensure that they are not skipping or repeating steps. Further, proper file documentation allows more thorough and productive management review of adjuster actions throughout the claim process to confirm that the facts of the claim are applied to the correct policy provisions. Finally, documenting the file gives defense attorneys a full picture of the claim to determine and strengths, weaknesses, or potential deficiencies to remedy.

Communicate, communicate, communicate. The benefit of prompt, thorough, and honest communication cannot be understated. A failure or lack of communication sows doubt in an insured's mind that the claim is being handled properly. Contacting the insured, public adjuster, expert witness, investigators, excess carriers, and any other individuals that are involved with a claim on a regular basis to provide updates will avoid accusations that the insurer is unreasonably delaying payment or not working to resolve a case. If an inspection is necessary to determine coverage, if records have been requested but not provided, if an examination under oath has not yet occurred but requested, the relevant

individuals should be informed. When circumstances arise that prevent resolution of a claim but that are not explained to an insured or relevant individual, they can assume that there is no basis, and the delay is frivolous. Further, explaining the basis for actions that an adjuster is taking shows that the purpose of those actions is not to delay or deny coverage under a pretext. Finally, communications should be factually accurate, include proper citations to policy language if applicable, and should be in accordance with prior positions unless new information requires otherwise.

While documentation and communication are key to effective claim handling, failing to act in accordance with internal and external policies, procedures, and requirements will often lead to allegations of bad faith. When liability has become clear or there is an undisputed aspect of coverage, insurers should make prompt payments and clearly explain the basis for those payments. When all or a portion of coverage is denied, ensure that all facts have been analyzed independently, the policy has been consulted, and state and federal law has been considered. It is imperative for insurers to avoid the mindset of denial, avoid denying portions of a claim to impact others, and avoid giving up on claim adjustment based on the expectation or anticipation of litigation. Insurers taking appropriate steps throughout the claim process to prevent and remedy bad faith actions is the best practice to avoid such allegations from the start.

Defending Bad Faith Actions

Once bad faith has been claimed, whether via a demand or suit, the first step to effective defense is determining the claim's validity, both procedurally and substantively. Each jurisdiction has different procedural requirements for bad faith including but not limited to; sending a time limited demand, allowing an insurer to correct coverage or claim handling deficiencies, including specific language that puts an insurer on notice of the intent to seek damages, notifying state departments of insurance about the bad faith allegations, and complying with policy conditions, and having a payable claim. Understanding the state specific procedural requirements for bringing a bad faith action is critical to defending such actions. Every bad faith claim should be taken seriously but when the proper procedures have not been followed for raising bad faith claims, procedural methods can be utilized to defend against the allegations. Counsel should utilize all methods available to advocate for their clients and a failure to understand a procedural defense to bad faith may prevent the raising of a proper defense.

After determining that procedural requirements have been met, look to the substantive allegations that have been raised as well as how bad faith is measured jurisdictionally. Bad faith allegations based on legitimate policy defenses, disputes between the opinions of qualified expert witnesses, disagreements between reasonable interpretations of insurance policies, refusals to settle frivolous cases, or cases where scope or pricing disputes exist generally do not rise to the level of bad faith. When cases involve these issues, use discovery and the litigation toolbox to explore the facts behind the allegations. Consider retaining consulting expert witnesses to review the opinions that have been formed during the case, seek out documents justifying the allegations, take depositions to determine the validity of the allegations, and continue reevaluating each

case on a regular basis. In jurisdictions where bad faith is measured until the time of trial, actions that an attorney takes can impact a client both positively and negatively. If a payment has not been made that should have been, make it. If an expert witness made a mistake, seek to correct or explain the error, when new information arises, consider how that will play to both a judge and a jury.

It is important to understand the jurisdiction standards for dispositive motions on bad faith. When moving for bad faith, a dispute of fact regarding coverage can show that no bad faith exists. This is a unique situation for a dispositive motion because in most cases, the absence of disputed material facts is required for a court to find in favor of the moving party. However, explaining how a dispute of fact regarding coverage shows the absence of bad faith in an insurer's determination can assist in obtaining judgements in favor of those insurers. Additionally, reliance on the advice of an independent expert witness and a reasonable interpretation of policy provisions can be a basis to argue that a dispositive motion should be granted on a bad faith claim. These jurisdictional distinctions should be reviewed and considered when determining the likelihood of success in dispositive motions on bad faith.

Conclusion

Bad faith claims raise many issues, only some of which have been discussed here, but the best defense is prevention. Proper adjustment is not a science, but training, management, communication, documentation, and thorough review can assist in avoiding bad faith from the start. When these claims arise, use the available resources to explore the basis for the allegations, to counter the allegations, and formulate a defense strategy that evolves as necessary.

Kevin Kelly is an insurance defense attorney representing domestic and international insurance carriers on first-party property claims defense and litigation involving various insurance coverage disputes, including loss of electronic data, bad faith, arson and fraud. Kevin believes in continuous communication with his clients and, as such, provides regular status updates and risk exposure analysis at all stages of litigation.