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Insurance Practice

The Bad Faith Sentinel

Standing guard on developments in the law of insurance bad faith around the country

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Court of Appeals of the State of Washington: Bad Faith Damages May Exceed the Amount of a Reasonable Covenant Judgment

***Miller v. Kenny*, No. 68594-5-I, 2014 WL 1672946 (Wash. Ct. App. Apr. 28, 2014)**

The Court of Appeals of the State of Washington held that a reasonable covenant judgment, consisting of the total liability of the insured to outstanding claimants, represented the minimum amount of damage suffered by an insured when his insurer failed to settle the claims in good faith.

On August 23, 2000, Patrick Kenny was driving with three friends on a road trip when he rear-ended a cement truck. All three of the passengers, Ryan Miller, Ashley Bethards, and Cassandra Peterson, were injured in the collision. The vehicle Kenny drove belonged to Cassandra Peterson and was insured under a Safeco insurance policy held by Peterson's parents.

After the accident, Miller, who experienced a head injury, contacted Safeco to inquire about the insurance policy limits, which Safeco refused to disclose. Miller subsequently filed suit against Kenny on December 20, 2001 in order to make the limits discoverable. Safeco undertook Kenny's representation without a reservation of rights and eventually Safeco disclosed the policy limits, which included $500,000 in liability coverage and umbrella policy limits of $1 million.

Miller contacted Safeco in an attempt to settle for the policy limits, giving the insurance company fair warning of a "substantial risk of an excess judgment." Peterson also sent a demand letter to Safeco, requesting settlement for $350,000. Not long after, Bethards demanded $1.25 million from Safeco.

Kenny's appointed defense counsel, Vickie Norris, realized at this point that the cumulative settlement demands from the passengers exceeded Safeco's policy limits. She reached out to Safeco's insurance adjuster on August 29, 2002 to demand that Safeco tender its policy limits in order to settle the pending claims. Safeco, however, refused to settle, disagreeing with Norris that the damages exceeded policy limits, and released only $500,000. Norris unsuccessfully attempted to negotiate a settlement with the three claimants using these funds.

Later in March 2003, after Miller's suit against Kenny had been set for trial, Safeco authorized Norris to tender the remaining $1 million in umbrella policy limits, along with the $500,000 limit of liability. By this point, though, Kenny was already attempting to reach a global settlement agreement with all three of the claimants. Kenny's agreement with the three passengers was finalized in May 2003. Kenny used the insurance proceeds from Safeco as well as other proceeds from a State Farm policy owned by his parents to negotiate a settlement for $1.8 million to be divided among Miller, Bethards, and Peterson. Additionally, Kenny assigned to Miller Kenny's rights to any bad faith claims against Safeco. In exchange, the three claimants agreed to not enforce any excess judgment against Kenny, which would later be determined by stipulation.

After learning of the settlement agreement, Safeco intervened to stipulate to an order that $4.15 million was the reasonable net amount of the stipulated covenant judgments. This number represented the total outstanding damages of the three claimants after deducting what they all received from the $1.8 million in insurance proceeds. All parties, including Safeco, agreed to the stipulation, which would treat the $4.15 million as if judgment had been entered against Kenny. Safeco, nevertheless, reserved defenses in the event of future litigation.

Subsequent to the agreement, Miller dropped his claims against Kenny and amended his complaint to pursue bad faith claims against Safeco as Kenny's assignee. Miller alleged that Safeco's failure to disclose policy limits led to the suit against Kenny and amounted to a failure to protect Kenny from an excess judgment. At trial, Miller argued that if Safeco had tendered its policy limits earlier, it would have avoided placing its insured in such a precarious position. Safeco countered that Miller was responsible for the delay in settlement by making excessive demands.

Ultimately, the jury found Safeco liable for $13 million on the bad faith claim. Prejudgment interest of $7 million, $1.7 million in attorney's fees and costs, as well as treble damages under the Consumer Protection Act brought Safeco's total liability to over $21.8 million. Safeco appealed this verdict, raising a host of issues.

Prior to trial, Miller moved for partial summary judgment to establish that the $4.15 million stipulated order merely set a floor for damages as the reasonable amount of the covenant judgment, or in other words, only represented "the minimal amount of harm if Safeco is liable." The jury was thus instructed that if Safeco were found liable, the jury must include at least the $4.15 million stipulated order in its damages calculation and should consider other damages beyond this. The jury awarded $7.75 million on top of the $4.15 million. Safeco argued that the jury should not have been allowed to award damages beyond what was agreed to in the stipulated order. Safeco further contended that Kenny suffered no harm because the covenant contained a promise by the claimants not to execute on an excess judgment against Kenny.

The court rejected Safeco's argument, noting that once bad faith has been established, a rebuttable presumption of harm arises. The court pointed out that Kenny was not released from liability; rather the agreement merely indicated that the other claimants would seek recovery from other assets, namely the insurance proceeds and Kenny's assignable bad faith claims. According to the court, "if an insurer acts in bad faith, an insured can recover from the insurer the amount of a judgment rendered against the insured, even if the judgment exceeds contractual policy limits." Safeco instead argued that language from prior cases describing a covenant judgment as the "presumptive measure of an insured's harm" limited an insured's recovery to the amount of a reasonable covenant judgment. The court disagreed, finding the measure of harm to the insured is "presumptively worth at least the amount of the covenant judgment—not less."

Explaining the rationale behind this rule, the court noted that an insured's damages are not limited solely to his or her liabilities to third parties captured in a reasonable covenant judgment. Rather, an insured may suffer damages caused solely by the insurer's bad faith. These damages may include a detrimental impact on the insured's credit rating, damage to reputation, loss of control of the case, attorney fees, other financial penalties, and even emotional distress. The court also pointed out that in a bad faith case, an insured is not limited to economic damages. Accordingly, the court upheld the trial court's instruction allowing the jury to consider additional damages beyond what was encompassed by the stipulated order.

On appeal, Safeco also called attention to discovery-related issues stemming from the bad faith verdict. One of these issues concerned Safeco's efforts to depose Miller's attorney, who Safeco accused of deliberately forestalling settlement to set up a bad faith claim. Safeco's attempt to question Miller's attorney invoked matters covered by the attorney-client privilege and the work product doctrine. The court quickly disposed of Safeco's argument, noting that pushing for a policy limit settlement was the attorney's "professional responsibility," and that keeping bad faith litigation as a possible backup strategy was not an unfair practice.

In another line of argument, Safeco contended that evidence of its reserves should have been excluded as irrelevant or prejudicial. The evidence demonstrated that Safeco knew that Kenny was exposed to liability well beyond policy limits each time it reviewed its reserves. According to the court, evidence of reserves in a personal injury suit is generally irrelevant and cannot be admitted to show liability. Yet, in bad faith litigation, "reserves may be relevant and admissible where the issue is whether the insurance company fulfilled its duty to adjust the insured's claim in good faith." Typically, policy concerns warrant excluding this type of evidence, but here the court made an exception because "the discrepancy between Safeco's loss reserves and its settlement posture was enduring and sizable."

As a final matter, Safeco objected to the trial court's failure to exclude deposition testimony of one of its claims analysts, Maryle Tracy, as irrelevant and prejudicial. At trial, the jury was shown a videotaped deposition of Tracy, in which she admitted that Safeco employed programs to reward its employees for keeping costs down. Upon review, the court found that this testimony was admissible and relevant to the bad faith claim. According to the court, "[t]he existence of these programs and the action by a claims analyst to conceal them supplied evidence of Safeco's motive to avoid settling for policy limits." After entertaining Safeco's remaining objections, the Court of Appeals affirmed the jury's verdict and denied Safeco's motion for a new trial.

Southern District of Mississippi: Insurer Providing Coverage Opinion to Insured Constitutes Waiver of Attorney-Client Privilege and Work-Product Protection as to all Communications Between Insurer and Coverage Counsel

***Willis v. Allstate Ins. Co.*, No. 2:13-CV-60-KS-MTP, 2014 WL 1882387 (S.D. Miss. May 12, 2014).**

The Southern District of Mississippi held that neither the attorney-client privilege nor the work product doctrine protected communications related to the insurer's advice-of-counsel defense after the insurer produced a coverage opinion during discovery.

After her home was damaged by fire, Sandra Willis filed a claim with her insurance carrier, Allstate Insurance Company. After initiating its investigation, Allstate hired attorney David Waldrop to determine the extent of coverage under Willis's policy. Waldrop produced a coverage opinion upon which Allstate relied in denying Willis's claim. After Allstate denied her claim, Willis sued Allstate for breach of contract and bad faith.

During discovery, Allstate provided Willis with a copy of Waldrop's coverage opinion to advance an advice-of-counsel defense, but withheld documents relating to communications with Waldrop. Soon after, Willis subpoenaed Waldrop for his "entire claim file" and all written communications between Waldrop and Allstate. Allstate moved to quash the subpoena, claiming that the documents were protected by the attorney-client privilege and the work product doctrine. While Allstate conceded that it waived the privilege with respect to the coverage opinion that it had provided to Willis, it nonetheless maintained that the waiver did not extend to Waldrop's entire file. Allstate argued that because the coverage opinion did not mention other documents in Waldrop's file, their content was not at issue.

The court held that Allstate could not use its coverage opinion to present an advice-of-counsel defense, yet deny Willis access to other documents which would provide needed context for understanding the opinion. Because Mississippi holds that waiver applies to all documents relating to the same subject matter, the court found that Allstate had waived the attorney-client privilege for all communications with Waldrop reflecting "coverage advice or opinions related to Plaintiff's claim for insurance proceeds."

Allstate also argued that the work product doctrine shielded the documents from discovery because the coverage opinion was not prepared as part of Allstate's daily course of business, but was rather prepared in anticipation of litigation. The court disagreed, finding that the coverage opinion was prepared in the course of Allstate's routine investigation of Willis's claim. Moreover, the court determined that Allstate waived any work product protection it might have had when it put coverage counsel's opinion at issue.

Consequently, the court required Allstate to produce all written communications and notes between Allstate and Waldrop related to Willis's claim. The court did not, however, require Waldrop to produce cases or research that he relied upon in drafting his opinion, determining that such materials did not bear on Allstate's asserted defense.

California Court of Appeals: Insurer Liable for Settlement Negotiated by Insured

***San Diego Apartment Brokers, Inc. v. California Capital Ins. Co.*, No. D062945, 2014 WL 1613449 (Cal. Ct. App. Apr. 22, 2014).**

California Court of Appeals affirms a jury verdict finding an insurer liable for settlement costs of its insured when the insurer refused to defend its insured in bad faith.

San Diego Apartment Brokers ("Brokers") managed The Pines Apartments, an apartment complex located in El Cajon, California. After receiving complaints from residents, Brokers barred bicycle riding in the complex's parking lot and other common areas. Despite the change in policy, a tenant's child continued to ride his bicycle in prohibited areas. Brokers' manager issued verbal and written warnings to the tenant, Jose Urista, which went unheeded. Brokers eventually served Urista with an eviction notice for failure to comply with the new policy. Not long after receiving the notice of eviction, Urista sued Brokers, alleging that the eviction was wrongful and discriminatory. Raising claims of negligence and violations of the Federal Fair Housing Act, Urista alleged that, as a result of the notice of eviction, he suffered from depression, sleep loss, humiliation, severe emotional distress, and bodily injury.

Once served with Urista's complaint, Brokers tendered a claim for defense to its general liability insurer California Capital Insurance Company ("CCIC"). At this point, Brokers had not yet evicted Urista, but had taken the precautionary step of refusing Urista's rent payment, so as not to invalidate the eviction notice. After Brokers submitted the complaint to the carrier for review, CCIC's senior branch manager contacted Brokers' attorney to inform him that CCIC would not defend Brokers because Urista had not been evicted and did not allege a bodily injury caused by an occurrence. In response, Brokers' coverage attorney, Brian Worthington, argued that a defense was required, noting that Urista's complaint sought recovery for wrongful eviction; Urista's family had moved out, potentially signifying constructive eviction; and Urista's complaint contained allegations of bodily injury.

After an evaluation of the claim by its own coverage attorney, CCIC again determined that it had no duty to defend Brokers under the policy, citing four reasons: 1) Urista did not claim a separate physical injury; 2) Broker's actions leading to the incident were decisions, not accidents; 3) a wrongful eviction had not taken place; and 4) even though Urista's family had moved out, Urista's continued residence precluded coverage. As a result of CCIC's denial, Brokers was forced to defend the claim on its own. Eventually, Brokers settled the suit with Urista for $20,000, despite Brokers' belief that the claim held no merit.

After the settlement with Urista, Brokers sued CCIC for breach of contract and bad faith. The court granted Brokers' motion for summary judgment on the issue of CCIC's duty to defend and the case proceeded to trial. The jury found that CCIC breached its duties under the insurance policy and its duty of good faith and awarded Brokers $30,552. CCIC appealed from the verdict.

On appeal, CCIC, in addition to disputing whether the jury properly determined that there was coverage under the policy, challenged the jury's finding bad faith for CCIC's refusal to defend Brokers. CCIC argued that it had not acted in bad faith because there was a genuine coverage dispute. CCIC specifically noted that it had relied on an opinion by Orloff, its coverage attorney, in denying Brokers' claim for a defense. The court rejected CCIC's argument and found that the jury's finding was supported by credible evidence.

First, the court noted that Brokers' expert witnesses testified that Urista's allegations of wrongful eviction and bodily injury were "clearly potentially covered lawsuits" that deserved a defense. According to the court, this testimony was sufficient to support the jury's finding that CCIC's decision not to defend was unreasonable. The court also rejected CCIC's argument that its denial was not in bad faith because there was a genuine coverage dispute evidenced by CCIC's reliance on the opinion of its coverage counsel.

The court explained that the jury could have found bad faith if Orloff's opinion was unreasonable or "if CCIC could not reasonably believe Orloff's opinion was correct" and that the record supported both factual findings. Orloff's assessment of Urista's claim contradicted the findings of CCIC's senior claims manager, who had already reviewed Urista's complaint. Further, Brokers presented expert testimony that Urista's claims were clearly pleaded, but simply ignored in Orloff's report. Even more tellingly, Orloff had testified during deposition that he was not acting as a neutral evaluator, but as a "forceful advocate for CCIC" in determining the applicable coverage. These factual findings supported the jury's determination that CCIC could not have reasonably relied on Orloff's coverage assessment, and that its refusal to defend Brokers was not taken in good faith.

Southern District of New York: Bad Faith Claim Based on Underlying Contract Claim Must be Dismissed as Duplicative

Orange v. The Travelers Indemnity Co., **No. 7:13-CV-06790-NSR (S.D.N.Y. May 14, 2014).**

The Southern District of New York granted an insurer's partial motion to dismiss insured's separate claim of bad faith as duplicative where insured also maintained a breach of contract claim and both claims were predicated on the same underlying contractual dispute.

In 2011, Hurricane Irene and Tropical Storm Lee damaged four properties owned by the County of Orange, New York. The County estimated its damages at over $400,000 for all four of its properties. The County filed claims for coverage with its insurer, Travelers Indemnity Company, under a $5 million policy which covered wind and water damage. Travelers denied the claim, informing the County that the properties were not covered under the policy. The County alleged that Travelers did not conduct an investigation before denying the claim and issued identical denial letters for all four properties even though the properties sustained different types of damage. The County subsequently sued Travelers for breach of contract and breach of the covenant of good faith and fair dealing in connection with the underlying insurance claims.

Travelers responded by filing a motion to dismiss the claim for breach of the implied covenant of good faith and fair dealing. Travelers argued that the County's bad faith claim was duplicative of the breach of contract claim because it was premised upon the same underlying facts. The County responded that the claims arose from separate sets of facts and argued that Travelers' decision to knowingly delay and deny the County's claim without investigation gave rise to a distinct cause of action premised in bad faith. The court disagreed. The court first noted that New York law recognizes an implied duty of good faith in every contract. As a result, the court "does not recognize a separate cause of action for breach of the implied covenant of good faith and fair dealing when a breach of contract claim, based upon the same facts, is also pled," because in those circumstances, the breach of the duty of good faith is essentially a breach of the contract. Unless the factual allegations supporting the bad faith claim were different from those of the contract claim, the bad faith claim could not survive a motion to dismiss, according to the court.

Ultimately, the court found that the facts supporting each of the County's claims stemmed from the same underlying cause: Travelers' failure to adhere to its contractual duties set forth in the insurance policy. It noted that the alleged delay and failure to investigate ultimately boiled down to a failure to comply with the agreement. The court also pointed out that the County's own complaint comported with this conclusion, where the County argued that Travelers "wilfully and in bad faith ignor[ed] the clear language of the Policy's provisions." As a result, the court granted Travelers' motion to dismiss the County's bad faith claim as duplicative of its breach of contract claim.

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