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Bad Faith in South Carolina Insurance Contracts : From Tyger River Pine Co. v. Maryland Cas. Co. to Mitchell v. Fortis Ins. Co.

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By Professor Constance A. Anastopoulo

Introduction

In 1933, the S.C. Supreme Court decided *Tyger River Pine Company v. Maryland Casualty Company*, 170 S.C. 286, 170 S.E. 346 (1933), and became one of the first states to establish a foundation not only for an insured's third-party claim for bad faith refusal to settle, but also for a claim for bad faith refusal to pay benefits. Because it is a judicially created doctrine, the doctrine of bad faith is refined with every related opinion of the Court. The S.C. Supreme Court's recent opinion on bad faith in *Mitchell v. Fortis*, 2009 WL 2948558, Sup. Ct. Op. No. 26718 (S.C. Sept. 14, 2009), is particularly noteworthy for its post-judgment use of federal and state case law to review and ultimately reduce a punitive damages award for bad faith rescission of an insurance policy. This article provides a general overview of bad faith law, discusses its evolution in South Carolina from *Tyger River* to *Mitchell*, and suggests that the opinions of the S.C. appellate courts in this area will continue to shape the doctrine in South Carolina and also as it develops in jurisdictions across the country.

Bad faith in general

A claim for bad faith typically arises in either the first- or third-party context. *See, e.g. Rakes v. Life Inv. Ins. Co. of Am.*, 582 F.3d 886, 895-96 (8th Cir. 2009).

First-party bad faith deals with the insurer's conduct in determining whether to indemnify the insured for loss suffered personally. *See generally* George J. Kefalos, *et al.*, *Bad-Faith Ins. Litigation in the South Carolina Practice Manual*, 13-AUG S.C. LAW. 18 (2001). Historically, courts construed a denial of benefits as a breach of contract and limited recovery accordingly. The nature of the insured-insurer contractual relationship, however, led to the emergence of a tort claim, providing additional theories of recovery intended to address the unique characteristics of the insurance contract. California was the first state to recognize an action for bad faith handling of a claim for first-party benefits in *Gruenberg v. Aetna Insurance Company*, 9 Cal. 3d 566, 108 Cal.Rptr. 480, 510 P.2d 1032 (1973).

Third-party bad faith, on the other hand, concerns the insurer's conduct in handling the insured's claim for coverage under a liability insurance policy. In this context, an insured files a claim for a defense to a third party's suit instituted against the insured and indemnification for the costs of any judgment suffered. Stated another way, the insurer owes two duties: (1) to defend a claim even if some or most of the lawsuit is not covered by insurance; and (2) to indemnify—to pay the judgment against the policyholder up to the limit of coverage. As these are contractual obligations, insurers must act with the utmost good faith and fair dealing in determining whether to and ultimately carrying out these duties.

Once the insurer has assumed

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control of the defense, including the right to accept or reject settlement offers, the implied duty of good faith and fair dealing requires the insurer to put the insured's interests on equal footing with its own. Thus, there is a duty to settle a reasonably clear claim against the policyholder within the policy limits to avoid exposing the policyholder to the risk of a judgment in excess of the policy limits. *See, e.g., Frontier Insulation Constr. v. Merch. Mut. Ins. Co.*, 91 N.Y.2d 169, 175-78 (1997).

Closely tied to this "duty to settle" is the concept of the excess liability claim. The claim first arose in *Crisci v. Security Insurance Company*, 66 Cal. 2d 425, 426 P.2d 173 (1967), where a third party offered to settle within the policy limits. *Id.* at 428, 426 P.2d at 175. After the insurer refused the offer, the insured suffered a judgment at trial substantially exceeding the policy limits. *Id.* at 428, 426 P.2d at 176. The insurer thereafter paid out only the policy limit, which it considered the extent of its contractual obligation. *Id.* at 428, 426 P.2d at 176. Consequently, the insured sued the insurer for: (1) loss of property; (2) mental distress; and (3) the amount by which the judgment exceeded the policy limits, all of which were caused by the insurer's refusal to settle. *Id.* at 427, 426 P.2d at 175. The court looked to the insurer's conduct in handling the third-party claim to determine the insurer's excess liability. *Id.* Guiding this inquiry was whether a reasonably prudent insurer without policy limits would have accepted the settlement offer. *Id.* at 430-32, 426 P.2d at 176-78. Although inconclusive, a judgment in excess of the policy limits raises the inference that accepting the offer was reasonable. *Id.* at 430, 426 P.2d at 176-77. Furthermore, rejection of such an offer renders the insurer liable for the amount of the final judgment whether or not within policy limits. *Id.*

In addition to the insured's own claim, the bad faith tort may extend to an injured third party despite the lack of privity between the injured third party and the insurer. *See generally Gaskins v. So. Farm Bureau*, 354 S.C. 416, 581 S.E.2d 169 (2003). However, the third party must first succeed in an action against the insured and receive a judgment in excess of the insured defendant's liability insurance policy limits. *Id.*

Bad faith in South Carolina

In South Carolina, bad faith is defined as "a knowing failure on the part of the insurer to exercise an honest and informed judgment in processing a bad claim," and "an insurer acts in bad faith where there is no reasonable basis to support the insurer's decision." *Am. Fire & Cas. Co. v. Johnson*, 332 S.C. 307, 311, 504 S.E.2d 356, 358 (Ct. App. 1998). Interestingly, South Carolina recognized the tort of third-party bad faith prior to the first-party bad faith cause of action. In *Tyger River Pine Company v. Maryland Casualty Company*, 170 S.C. 286, 170 S.E. 346 (1933), our Supreme Court adopted a tort cause of action for an insurer's unreasonable refusal to accept a settlement within the policy limits. 170 S.C. 286, 170 S.E. 346 (1933). Under the *Tyger River Doctrine*, a liability insurer owes a duty to settle

claims covered by the policy if it is the reasonable thing to do. *Trotter v. State Farm Auto. Ins. Co.*, 297 S.C. 465, 475, 377 S.E.2d 343, 349 (1988). Where the insurer "unreasonably refuses or fails to settle a covered claim within the policy limits, [it] is liable ... for the entire amount of the judgment obtained against the insured regardless of the limits contained in the policy." *Doe v. S.C. Med. Mal. Liability Joint Underwriting Ass'n*, 347 S.C. 642, 557 S.E.2d 670 (2001). Moreover, the S.C. Court of Appeals has held that a bad faith claim may exist even absent the insurer's breach of an express contractual provision. *Tadlock Painting Co. v. Maryland Cas. Co.*, 336 S.C. 89, 518 S.E.2d 608 (Ct. App. 1999).

In *Nichols v. State Farm Mutual Automobile Insurance Company*, 279 S.C. 336, 306 S.E.2d 616 (1983), South Carolina extended the *Tyger River Doctrine* to the first-party context, where the court held that if an insured can show bad faith or unreasonable refusal by an insurer to pay first party benefits, he or she can recover compensatory damages not limited to the amount on the face of the insurance contract. *Id.* at 340, 306 S.E.2d at 619. The *Nichols* court also explained why the claim should be in tort, not contract: "Absent the threat of a tort action, the insurance company can, with complete impunity, deny any claim they wish, whether valid or not. During the ensuring period of litigation, following such a denial, the insurance company has the benefit of profiting on the use of the insured's money." *Id.* at 340, 306 S.E.2d at 619. The insured, therefore, "is entitled to receive the additional security of knowing that she will be dealt with fairly and in good faith. That security comes not from the express contractual terms, but from the implied covenant of good faith and fair dealing." *Tadlock*, 322 S.C. at 502, 473 S.E.2d at 54. To succeed in a third-party bad faith action, the insured must prove:

> (1) the existence of a mutually binding contract of insurance between the plaintiff and the defendant; (2) refusal by the insurer to pay benefits under the contract; (3) resulting from the insurer's bad faith or unreasonable action in breach of an implied covenant of good faith and fair dealing arising on the contract; (4) causing damage to the insured.

Crossley v. State Farm Mut. Auto. Ins. Co., 307 S.C. 354, 359-60, 415 S.E.2d 393, 396-97 (1992). In *Cock-N-Bull Steak House, Incorporated v. General Insurance Company*, 321 S.C. 1, 6, 466 S.E.2d 727, 730 (1996), the S.C. Supreme Court construed an insurer's delay in paying first-party benefits as sufficient to satisfy the above elements. *Id.* 321 at 6, 466 S.E.2d at 730.

Although bad faith is a judicially created doctrine, South Carolina, like many states, has enacted statutes relevant to the doctrine of bad faith, including the Insurance Trade Practices Act, S.C. Code Ann. §§ 38-57-10, *et seq.* (1989), and the Claims Practices Act, S.C. Code Ann. §§ 38-59-20, *et seq.* (1989). The Insurance Trade Practices Act prohibits insurers from misrepresenting an insurance policy with the intent to settle the claim "on less favorable terms than those provided in and contemplated by the contract or policy." § 38-57-70. The Department of Insurance is vested with determining whether an insurer has violated the insurance code, and the statute has been construed as evidencing legislative intent to create an administrative remedy and not a private right of action. *Masterclean v. Star Ins. Co.*, 347 S.C. 405, 556 S.E.2d 371 (2001). The Claims Practices Act, on the other hand, identifies practices that the legislature considers improper if committed without just cause and performed with such frequency as to indicate a general business practice. *See* § 38-59-20. C. CODE ANN. § 38-59-20 (1976). The statute provides administrative relief for a third party victim of an improper claims practice. § 38-59-10, *et seq.* This relief is important because South Carolina does not recognize a third-party action for bad faith refusal to

pay insurance benefits. *Kleckley v. N.W. Nat'l Cas. Co.*, 330 S.C. 277, 498 S.E.2d 669 (1998). Similarly, third parties do not have a private right of action under Section 38-59-20. *Gaskins v. So. Farm Bureau Cas. Ins. Co.*, 343 S.C. 666, 541 S.E.2d 269 (Ct. App. 2000). Instead, third parties are entitled to administrative review before the Chief Insurance Commissioner. *Masterclean v. Star Ins. Co.*, 347 S.C. 405, 556 S.E.2d 371 (2001).

***Mitchell v. Fortis Ins. Co.*, 2009 WL 2948558, Sup. Ct. Op. No. 26718 (S.C. Sept. 14, 2009)**

In *Mitchell v. Fortis Insurance Company*, South Carolina's most recent addition to bad faith jurisprudence, a policyholder brought causes of action for breach of contract and bad faith rescission of insurance policy, seeking actual and punitive damages. 2009 WL 2948558, Sup. Ct. Op. No. 26718 (S.C. Sept. 14, 2009). The claims arose from the defendant's handling of the insured's claim and the subsequent termination of the insured's policy. *Id.* at 1. Mitchell, a 17-year-old African-American male, applied for health insurance with Fortis, indicating he had never been diagnosed with any immune-deficiency disorder. *Id.* After he received an insurance policy, he subsequently learned he was HIV-positive when attempting to donate blood to the Red Cross. *Id.* After he began treatment, Fortis received claims for same, prompting an investigation to determine whether Mitchell failed to disclose a pre-existing condition. *Id.* The investigation revealed an erroneously dated doctor's intake note, and a senior underwriter recommended rescission of the policy, which the rescission committee granted after "what was likely no more than a three-minute review." *Id.* After receiving notification of rescission, Mitchell repeatedly attempted to prove he did not misrepresent his health status, and Fortis repeatedly refused to investigate further. *Id.* At trial, evidence showed that Fortis routinely shut down investigations once a single piece of evidence was discovered to support rescission. *Id.* Additionally, the jury considered the actions of the insurer in light of this unique case involving HIV and the consequences that terminating the plaintiff's health insurance policy had and would have on the plaintiff's access to treatment and medicine. *Id.* at 42. Following trial, the jury awarded: (1) $36,000 in actual damages for breach of contract; (2) $150,000 in actual damages on the bad faith rescission claim; and (3) $15 million in punitive damages deriving from the bad faith cause of action. *Id.* at 1-2. The defendants filed several post-trial motions, including a motion for the plaintiff to elect remedies. *Id.* Thereafter, the court granted the defendant's motion to elect, and not surprisingly, the plaintiff elected actual and punitive damages on the bad faith cause of action. *Id.* at 3.

On appeal, the S.C. Supreme Court conducted a de novo review of the district court's determinations of the constitutionality of punitive damages awards. *Id.* at 36. The Court first considered the defendant's

motion that the punitive damage award was so excessive as to violate its constitutional right to due process under the standards set forth in *Gamble v. Stevenson*, 305 S.C. 104, 406 S.E.2d 350 (1991) and *BMW of North America v. Gore*, 517 U.S. 559 (1996). *Id.* Under the de novo review, the Court addressed the considerations outlined in prior decisions: 1) the defendant's degree of culpability; 2) the duration of the conduct; (3) the defendant's awareness or concealment; 4) the existence of similar past conduct; 5) the likelihood the award will deter the defendant or others from like conduct; 6) whether the award is reasonably related to the harm likely to result from such conduct; 7) the defendant's ability to pay; and 8) any other factors deemed appropriate. *Id.* at 39.

In contemplating both the *Gore* and *Gamble* factors, the Court held that *Gamble* remains relevant to the post-judgment due process analysis, but only insofar as it adds substance to the *Gore* guideposts, rather than requiring that both considerations be fully evaluated separately. *Id.* at 40. In addressing the degree of reprehensibility, the Court particularly considered the plaintiff's diagnosis of HIV and the "great risk" to which he was exposed as a result of the actions of the insurer in terminating his health insurance policy given the likelihood of death of HIV positive patients without any treatment. *Id.* at 42. Finding that it was reasonable for a jury to conclude that the insurer was motivated to avoid the losses it would undoubtedly incur in supporting the plaintiff's costly medical care because of his HIV status, the insurer demonstrated an indifference to Mitchell's life and a reckless disregard to his health and safety. *Id.* at 41-42. After extensive review of the other considerations, the Court eventually remitted the punitive award to $10 million from the jury award of $15 million. *Id.*

Mitchell is important in two respects. First, South Carolina reaffirmed prior case law holding that there is no bright-line qualitative formula to determine an appropriate actual-to-punitive damages ratio. The Supreme Court, therefore, reaffirmed the eight due process considerations outlined in *Gamble v. Stevenson*, 305 S.C. 104, 406 S.E.2d 350 (1991), to the extent that they add substance after using *BMW of N. Am. v. Gore*, 517 U.S. 559 (1996), as the paramount consideration in reviewing the propriety of a punitive damages award post-judgment. The decision in *Mitchell* allowing the punitive damage award to stand after being remitted must be considered in light of the unique situation of this particular case, especially with regard to the plaintiff's vulnerability as an HIV positive patient and the actions of the insurer that would result in a denial of access to treatment and medicine ensuring almost certain death of the plaintiff.

Secondly, the *Mitchell* decision addressed the issue of bad faith in finding that evidence that the health insurer engaged in improper conduct when it voted to rescind insured's policy based on an erroneous determination that insured had misrepresented his HIV status on his application, including concealment of insured's rights to appeal that determination, and acted to conceal its own wrongdoing after it discovered that basis for rescinding policy was incorrect, was relevant to show insurer's liability for bad faith in rescinding policy.

Conclusion

Few things are certain in bad-faith jurisprudence. The one thing we can be sure of is that bad faith is a fluid concept, subject to change with every decision. Whether in the first-party or third-party context, public policy concerns and the competing interests of the insured and the insurer continue to drive the evolution of the doctrine of bad faith. The Supreme Court's recent opinion in *Fortis* makes it clear that South Carolina will remain on the cutting edge of the refinement of the doctrine of bad faith and, in doing so, will impact insurance contracts here at home as well as those across the country.

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