2011

BAD FAITH: BUILDING A HOUSE OF STRAW, STICKS, OR BRICKS

Constance A. Anastopoulo, *Charleston School of Law*

BAD FAITH: BUILDING A HOUSE OF STRAW, STICKS, OR BRICKS

CONSTANCE A. ANASTOPOULO*

The third little pig . . . built his house with [bricks] . . . and lived happily ever afterward.

—*The Three Little Pigs*[1]

I. INTRODUCTION

As the tale goes, the first little pig decides to build his house out of straw, the second little pig builds his house out of sticks, and the third little pig builds his house out of bricks. The house of bricks offered the greatest protection and resistance to the power of the big, bad wolf, and despite the fact that the wolf huffed and puffed, he could not blow that house down. Each of the three pigs chose a different material: flimsy straw, somewhat reliable stick, and sturdy brick. When assaulted by the wolf, only the brick house stood unharmed.

Even the simplest reference to this story is a reminder that it is wise to be prudent, cautious, and careful in order to be protected. Protection is, of course, the primary reason consumers purchase insurance. However, what if an insured finds his insurance company is failing to protect him and that the insurer's bad faith has made the company a bigger, more threatening, wolf?

By examining representative cases and reviewing statutory schemes, this Article compares and contrasts the "bad faith" law of all fifty states and the various approaches to consumer claims of insurer bad faith. It identifies three distinct levels of protection:

---

* Assistant Professor of Law, Charleston School of Law; J.D., University of North Carolina School of Law; I would like to thank Aleatra Williams (Charleston School of Law) and Thomas P. Gressette, Jr. for their helpful comments on earlier drafts of this Article. I would like to thank my law clerk and research assistant, Gary W. Patterson, a third-year student at the Charleston School of Law, who was instrumental in the research and writing of this Article. Also, I would like to thank Akim, without whom none of this would be possible.

1. *See* JOSEPH JACOBS, ENGLISH FAIRY TALES 68–72 (2d ed. 1892).

straw, stick, and brick. The amount of protection a particular insured has depends on the causes of action available in his jurisdiction. So, unlike the three little pigs that chose *their own* building materials, insureds alleging bad faith are protected only to the degree that *their jurisdiction* chooses to recognize personal claims for bad faith.

Before applying the analogy, however, it is important to first understand the current state of bad faith claims in insurance law. Part II of this Article discusses insurance claims generally and provides a background for bad faith claims. Part III details the circumstances under which bad faith claims arise, the different types of claims, and parties that may bring them.

Part IV classifies each state by the level of protection it offers bad faith claimants. Each of the three little pigs' building materials—straw, stick, or brick—correlates to a state's choice in providing protection to potential victims of unfair or improper insurance practices. The states can be divided into three categories: (1) jurisdictions that offer the least amount of protection and fewest avenues of recovery to plaintiffs—the "straw states"; (2) jurisdictions that offer moderate protection with broader rights of action—the "stick states"; and (3) jurisdictions that offer the most protections and avenues of recovery, including possible rights to third-party claimants to bring actions—the "brick states."

In order to fully examine the nuances of bad faith claims, this Article next considers the conduct required to constitute bad faith as defined by each state. The more a state's law specifically defines "improper conduct," the better the insurer clearly understands its duties in handling claims and how to avoid bad faith claims. Some states have more substantive law in the arena of bad faith than others. This Article will address each state to the extent that the "bad faith" law has developed.

Analogizing insurance companies to the big, bad wolf is not to say simplistically that all insurance companies are bad. Rather, it is the practices of handling claims in an unfair and improper manner that are the acts upon which this analogy is derived. Considerations regarding proper claim handling include whether the insurer has a reasonable basis for denying or delaying payment on a claim, whether the insurer timely investigates a claim, and what timeframes for investigating and paying claims are appropriate. Obviously, not every insurance company is bad and not every claim is handled improperly. This Article is not intended to impugn insurance companies. Rather, it analyzes, compares, and

contrasts the various states' methods of defining bad faith to provide a useful tool in determining when bad faith claims are appropriate and how they are determined.

To address the inconsistencies from state to state, Part V reviews the Model Rules as promulgated by the National Association of Insurance Commissioners. This Part demonstrates how those rules differ from state definitions, the extent to which states have adopted those rules, and how those rules might give guidance in this area of the law. Finally, Part VI offers ways both plaintiffs and defendants can better navigate the world of bad faith claims, and steps to take to avoid these claims. Part VII offers the author's closing remarks.

As insurance contracts and the obligations associated therein grow more complicated and far-reaching, courts have witnessed an increase in the number of bad faith claims being filed and litigated. Innumerable questions abound. Are claims increasing because the definition and application of bad faith is changing, or are other factors at play? What role does the availability of various *types* of claims play in the increase in this area of litigation? Importantly, insurance policies are only as good as the insurance company's willingness to pay.[2] An insured's confidence is only as secure as his reasonable belief the policy will adequately provide protection. As the business of insurance is greatly affected by the public interest, the implications of this increase in bad faith claims for the insurer–insured relationship are great.[3] It is important to understand the origin of bad faith in order to determine how it is treated in each state.

II. INSURANCE, GENERALLY, AND THE BASICS OF BAD FAITH CLAIMS

The insurance industry is a large and powerful industry comprised of relationships between insureds who want to protect themselves from unforeseen expenses and insurers who are able to make a profit by paying as few claims as possible. Insurance is most simply defined as a "contract where one undertakes to in-

2. *See* S.C. CODE ANN. § 38-59-20(8) (2002) (including any practice that constitutes unreasonable delay or failure to pay in the definition of "improper claim practices").

3. *See* Hinds v. United Ins. Co. of Am., 149 S.E.2d 771, 774–75 (S.C. 1966).

demnify another or pay a specified amount upon determinable contingencies."[4] In 1944, Supreme Court Justice Hugo Black stated, "Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States."[5]

Due to a keen governmental interest in having its citizens adequately protected, the insurance industry is regulated through state legislatures, regulatory agencies created by statute, and the judiciary.[6] It is a booming business: the insurance industry's net premiums totaled $1.2 trillion in 2008.[7] Global insurance premiums in 2009 were $4.1 trillion, with the U.S. representing $1.14 trillion of that number.[8] Insurance companies have the power to influence regulation and influence state legislatures through their ability to hire lobbyists, make campaign contributions, and generally flex their muscles, but the question remains as to what protections are available for insureds?

As a result of numerous factors, the modern concept of bad faith is fluid, and no bright-line test exists to determine when an insurer's conduct constitutes bad faith. Further complicating the issue is the fact that there is no consensus among the states. Each state has its own body of law outlining the causes of action and the eligible parties. Common in all cases, though, is the existence of an insurance contract. Therefore, the typical "bad faith" analysis begins by examining the insurance policy itself and the duties it imposes upon the insurer. Even then, it is important to understand that there is generally a lack of uniform policy language to clearly

---

4. S.C. CODE ANN. § 38-1-20(25) (Supp. 2011).

5. United States v. South-Eastern Underwriters Ass'n, 322 U.S. 533, 540 (1944), *superseded by statute*, The McCarran–Ferguson Act, ch. 20, 59 Stat. 33 (codified at 15 U.S.C. §§ 1001–1015 (2006)).

6. *See generally* Susan Randall, *Insurance Regulation in the United States: Regulatory Federalism and the National Association of Insurance Commissioners*, 26 FLA. ST. U. L. REV. 625 (1999) (advocating for an increase in the regulation of the insurance industry).

7. INS. INFO. INST., *Full Year 2008 Results Show P/C Industry Well Capitalized Despite Being Pummeled by Catastrophes, Recession, and the Financial Crisis* , (Apr. 9, 2009), http://www.iii.org/press_releases/222599.html.

8. MARKO MASLAKOVIC, THE CITYUK, INSURANCE 2010 3 (Dec. 2010), http://www.thecityuk.com/assets/Uploads/Insurance-2010.pdf.

and comprehensively define an insurer's duties.[9] Although some standardized language exists in insurance contracts, there is no magic cluster of homogenous words defining the existence or scope of the insurer's duties under various policy provisions. "Bad faith . . . is a term of variable significance and rather broad application."[10] Just what meets the criteria for bad faith must be determined on a case-by-case basis.[11]

Recognition of a "bad faith" cause of action has been primarily driven by fact-intensive state court decisions and sometimes inconsistent state regulation. Many states, for instance, have enacted statutory schemes identifying what its legislature deems unfair or improper practices,[12] but many of these statutes, either explicitly or through judicial interpretation, prohibit a private right of action for individual claimants.[13] To illustrate, some states have identified such practices as "failing to adopt and implement reasonable standards for the prompt investigation and settlement of

---

9. William K. McVisk, *The Case for Bad Faith Damages in English Insurance Law: Why Insurers Should Stop Hating and Start Loving Bad Faith Remedies*, (Jun. 30, 2005), http://www.bila.org.uk/lecture_scripts/Expert_ Report_ McVisk.pdf.

10. Hilker v. W. Auto. Ins. Co., 235 N.W. 413, 414 (Wis. 1931) (discussing provisions on the rights and duties of the insurer with regard to settlements).

11. *See, e.g.*, Careau & Co. v. Sec. Pac. Bus. Credit, Inc., 272 Cal. Rptr. 387, 399–400 (Cal. Ct. App. 1990) ("Just what conduct will meet this criteria [of bad faith actions] must be determined on a case by case basis and will depend on the contractual purposes and reasonably justified expectations of the parties."); Zumwalt v. Utils. Ins. Co., 228 S.W.2d 750, 754 (Mo. 1950) ("Each case [regarding bad faith] must stand and be determined upon its particular state of facts." (internal quotation marks omitted)).

12. For examples of various state statutes defining unfair practices, see CAL. INS. CODE § 790.03 (West 2005 & Supp. 2012); N.C. GEN. STAT. § 58-63-15 (2011); OHIO REV. CODE ANN. § 3901.21 (LexisNexis 2010 & Supp. 2010); and S.C. CODE ANN. § 38-59-20 (2002).

13. *See, e.g.*, N.C. GEN. STAT. § 58-63-15(11) (stating that "no violation of this subsection shall of itself create any cause of action in favor of any person"); *see also* Ocean Winds Council of Co-Owners, Inc. v. Auto-Owners Ins. Co., 241 F. Supp. 2d 572, 578 (D.S.C. 2002) (broadly interpreting S.C. CODE ANN. § 38-59-20 in state court decisions as barring private rights of action for first-party claimants); Whitney v. Blue Cross & Blue Shield of N.C., No. COA06-1172, 2007 WL 2034071, at *4–5 (N.C. Ct. App. July 17, 2007) (stating that while there is no cause of action under the statute defining "unfair" or "deceptive" practices, there would be a remedy under the statute regulating the practices).

claims, including third-party liability claims, arising under its policies" as unfair and improper claims practices.[14] However, the same states prohibit direct private actions either through statutory language or case law.[15] Even when not explicitly prohibited, few jurisdictions recognize an implied cause of action for violations of similar statutes.[16]

Usually, a department of insurance or similar state agency is charged with enacting and enforcing the respective state insurance code, including codifications of improper claims practices. The statutory provisions often do not permit those directly affected by the practice to bring an action. Only an administrator may bring an action, but that is generally limited to fines, "cease and desist" letters, and other penalty orders.[17] Importantly, most states that recognize *statutory* obligations of good faith and fair dealing do not acknowledge a common law tort action for "bad faith." The statutes are generally based on the parties' contractual obligations and, as such, only allow unfair practices claims to proceed after liability on the underlying breach of contract action has been determined.[18] In contrast, in states that recognize *common law* obligations of good faith and fair dealing, an insured may be allowed to bring a tort action for bad faith at the same time as a breach of contract claim.[19] Obviously, the contemporaneous resolution of the claims is beneficial to the claimant.

---

14. S.C. CODE ANN. § 38-59-20(3). *See also* CAL. INS. CODE § 790.03; OHIO REV. CODE ANN. § 3901.21. Note that the statutory language does not use the term "bad faith."

15. Masterclean, Inc. v. Star Ins. Co., 556 S.E.2d 371, 377 (S.C. 2001).

16. *See* ERIC MILLS HOLMES & WILLIAM F. YOUNG, CASES AND MATERIALS: REGULATION AND LITIGATION OF INSURANCE 400–01 (Robert C. Clark et al. eds., 3d ed. 2007).

17. *Id.*; *see also Masterclean*, 556 S.E.2d at 377 (stating South Carolina's statute was intended to "create an administrative remedy and not a private right of action").

18. *See, e.g.*, Lawton v. Great Sw. Fire Ins. Co., 392 A.2d 576, 580–81 (N.H. 1978) ("The insured must . . . prove that the insurer's failure or delay in payment was a breach of contract. Not every delay or refusal . . . will constitute a breach of contract.").

19. *See, e.g.*, Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980) ("A violation of this duty [to act in good faith] will give rise to an independent claim in tort . . . ."); Mitchell v. Fortis Ins. Co., 686 S.E.2d 176, 185 (S.C. 2009) (upholding, but remitting, an award of punitive damages for a tort claim of bad faith).

To illustrate the difference, a recent South Carolina case demonstrates the importance of protecting a claimant's right to bring contemporaneous actions against an insurer whether that protection is defined and created by statute or common law.[20] In *Mitchell v. Fortis Insurance Co.*, the South Carolina Supreme Court emphasized that the insurer's bad faith rescission of the policy exposed the insured to risk of physical danger and death, demonstrated an indifference to the insured's life, and constituted reckless disregard for his health and safety, particularly when the insured was financially vulnerable.[21] In the case, Mitchell applied for health insurance with the defendant Fortis Insurance Company, and indicated he had never been diagnosed with any immune-deficiency disorder.[22] After he received an insurance policy, he learned he was HIV-positive, and once he made insurance claims, Fortis believed he failed to disclose a pre-existing condition.[23] The investigation revealed an erroneously dated doctor's intake note, on which the Fortis rescission committee based their decision to terminate the policy after what the court deemed "was likely no more than a three-minute review."[24]

At trial, evidence showed that Fortis routinely "shut down an investigation once a single piece of evidence was discovered to support rescission."[25] Upholding a punitive damages award, the court noted that the insurer's conduct involved "repeated acts of deliberate indifference" over a two-year period and that Fortis affirmed its decision even after learning that its basis for rescinding the policy was incorrect.[26] Admittedly, this case represents unique facts where the insurer's improper policy rescission left the insured with few treatment options while his deadly disease progressed and, thereby, exposed him to grave harm. Nonetheless, it illustrates the importance of protecting a claimant's right to bring an immediate action for bad faith against an insurer when he or she has little other recourse. Despite repeated attempts by the insured

---

20. As is more fully discussed in Part IV.B, South Carolina bad faith jurisprudence has garnered national attention both as an early pioneer and for its continued development in this area of the law.

21. *Mitchell*, 686 S.E.2d at 186.

22. *Id.* at 180.

23. *Id.*

24. *Id.* at 180–82.

25. *Id.* at 181.

26. *Id.* at 186–87.

in *Mitchell* to use avenues of administrative appeal and insurer review, he was denied reinstatement of his policy.[27] Only after exhaustion of the administrative remedies offered by the insurer was Mitchell able to bring an action for breach of contract and bad faith rescission against his insurance company under South Carolina law.[28]

A. The Obligation of Good Faith and Fair Dealing

The origins of bad faith begin with the contract. "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[29] As early as 1882, it was said that the rule of good faith and fair dealing "should enter into and form a part of every insurance contract."[30] Nearly a century later, a New Jersey court characterized insurance policies as contracts of "the utmost good faith."[31] The obligation of good faith seemingly prohibits the insurer from doing anything to impair the insured's rights to the benefit of his contract.[32] Despite the worthiness of this good faith obligation, courts have failed to adequately define what specific type of conduct constitutes bad faith.[33] This adds to the lack of clarity on the part of the insured and insurer as to what specific actions may give rise to bad faith claims.

B. The Duty Not To Commit Bad Faith

Most jurisdictions describe the substantive law of bad faith with circular reasoning, explaining that "an insurer that breaches its duty of good faith and fair dealing commits the tort of bad faith."[34] Indeed, the Tennessee Court of Appeals once noted it was unaware "of any reported cases which provides [sic] a concise def-

---

27. *Id.* at 180–81.
28. *Id.* at 179–81.
29. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).
30. Germania Ins. Co. v. Rudwig, 80 Ky. 223, 235 (Ky. 1882).
31. Bowler v. Fid. & Cas. Co. of N.Y., 250 A.2d 580, 587 (N.J. 1969).
32. *Id.* at 587–88.
33. *See* George L. Blum, Annotation, *What Constitutes Bad Faith on Part of Insurer Rendering It Liable for Statutory Penalty Imposed for Bad Faith in Failure to Pay, or Delay in Paying, Insured's Claim—Particular Conduct of Insurer*, 115 A.L.R 5TH 589 (2004).
34. Douglas R. Richmond, *Bad Insurance Bad Faith Law,* 39 TORT TRIAL & INS. PRAC. L.J. 1, 4 (2003).

inition of bad faith. Most of the cases which deal with the subject of bad faith give guidance as to what is *not* bad faith."[35]

In the insurance context, the doctrine of bad faith emerged in third-party liability cases, as demonstrated in *Hilker v. Western Auto Insurance Co.*, where the Supreme Court of Wisconsin noted that an insurer may be liable for failure to settle or compromise a claim if the insurer failed to meet its duty not to act in bad faith.[36] Seeking to provide substantive guidance to this elusively defined duty, the court held an insurer must exercise the care and diligence of ordinarily prudent persons in the investigation and adjustment of claims.[37] Although subsequent courts addressing bad faith claims ruled similarly, the rules and analysis tend to be based on contract theories like the implied covenant of good faith and fair dealing, rather than tort theories like negligence.[38]

Courts struggle to distinguish the rules of bad faith and often combine contract and tort concepts.[39] In *Allstate Insurance Co. v. Miller*, for example, the Nevada Supreme Court defined bad faith as "an actual or implied awareness of the absence of a *reasonable* basis for denying benefits of the [insurance] policy."[40] In other words, an insurer's improper or unfair action may not always give rise to a bad faith cause of action; they will not be liable so long as they did not know their decision was unreasonable. This tension as to what constitutes bad faith and what constitutes a reasonable basis is a repeated theme in many states.[41] It is clear from the case law that the definition of bad faith continues to evolve. Therefore it is instructive to understand how bad faith claims may arise in practice.

---

35. Johnson v. Tenn. Farmers Mut. Ins. Co., No. E2004-00250-COA-R3-CV, 2005 WL 549195, at *11 (Tenn. Ct. App. Mar. 9, 2005), *aff'd in part*, *rev'd in part on other grounds*, 205 S.W.3d 365, 370–72 (Tenn. 2006).

36. Hilker v. Western Auto Ins. Co., 235 N.W. 413, 414 (Wis. 1931).

37. *Id.* at 415.

38. *See* Condio v. Erie Ins. Exch., 899 A.2d 1136, 1142–43 (Pa. Super. Ct. 2006).

39. *See, e.g.*, Brown v. U.S. Fid. & Guar. Co., 314 F.2d 675, 677 (2d Cir. 1963) ("Much ink has been spilled in an effort to define and to distinguish the rule of negligence from the rule of bad faith.").

40. Allstate Ins. Co. v. Miller, 212 P.3d 318, 324 (Nev. 2000) (quoting Am. Excess Ins. Co. v. MGM Grand Hotels, Inc., 729 P.2d 1352, 1354–55 (Nev. 1986)) (emphasis added) (internal quotation marks omitted).

41. *See* Blum, *supra* note 33.

III. HOW BAD FAITH CLAIMS ARISE IN PRACTICE

Bad faith claims can be divided into two groups: first-party claims and third-party claims. Courts distinguish between these two because the type of claim will determine the avenues of recourse available to the claimant. First-party claimants are distinguished by the special protections offered to them through privity of contract with the insurer. Third-party claimants generally have no direct recourse against an insurer, but may gain limited rights through an assignment agreement with the insured. It is important to realize that with each judicial decision, the changes in bad faith law impact the rights of action available to more than one class of possible claimants.

With respect to first-party claimants, most insurance disputes involve the competing interests of insurers who do not want to pay unwarranted claims and insureds who want their claims paid quickly and fairly. Insureds, who generally lack equal bargaining power with the insurer, contract to protect themselves against the specter of accidental or unavoidable loss.[42] At the same time, insurance companies have a vested interest in being able to accurately predict their obligations and make appropriate business decisions that will foster economic success. Accurate claim forecasting enables insurance companies to pay obligations to policyholders when unavoidable losses arise. However, the unequal bargaining power leaves the policy holders vulnerable to unfair practices that the insurance companies may use to achieve their goals. Bad faith claims are one way to ensure that the policy holders get the benefit of their bargain.

As to third-party claimants, insurers have an interest in protecting the assets of their companies, shareholders, and policyholders, and avoiding payments on claims to undeserving third parties. However, conflicts of interest arise when a first party's unavoidable loss involves a third party's claim that the insurance company does not want to pay.

Two landmark California decisions form the basis for the modern treatment of first-party and third-party bad faith insurance claims. In *Gruenberg v. Aetna Insurance Co.,* the Supreme Court of California recognized a first-party claim of bad faith when an

---

42. Trimper v. Nationwide Ins. Co., 540 F. Supp. 1188, 1193 (D.S.C. 1982).

insurer denied the plaintiff's claim after his restaurant was destroyed in a fire.[43] The defendant–insurer falsely implied that the plaintiff had motive to burn down his restaurant.[44] In its analysis, the court stated that in every insurance contract there is an implied covenant of good faith and fair dealing, and this duty applied equally whether the insurer is dealing with the claims of third persons against the insured or with the claims of the insured.[45] In *Comunale v. Traders & General Insurance Co.*, the California Supreme Court recognized a third-party claim of bad faith when the plaintiffs received a judgment in excess of the insured's policy limits and obtained an assignment of the at-fault's/insured's rights against the insurer.[46] The court reiterated that the insurer breached the covenant of good faith and fair dealing when it wrongfully refused to defend the action and refused to accept an offer of settlement within the policy limits. The breach exposed the insured to an excess judgment, and therefore the insurer could be liable for that excess.[47] These decisions illustrate that bad faith claims can arise as either first-party or third-party claims.

Following California's lead, other states took note of the growing need to recognize alternative claims in addition to the general breach of contract claims for policyholders when insurers failed to satisfy contractual obligations.[48] Some state legislatures have even passed legislation specifically authorizing bad faith claims.[49]

A. Tort Claims Versus Contract Claims

Conflicts between the insurer and insured are generally based on a violation of good faith, but two legal theories can pro-

---

43. Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1034 (Cal. 1973).

44. *Id.* at 1035.

45. *Id*. at 1038.

46. Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 200–03 (Cal 1958).

47. *Id.* at 200–02.

48. For cases adopting the rule from *Gruenberg*, see: Grand Sheet Metal Prods. Co. v. Protection Mut. Ins. Co., 375 A.2d 428, 430 (Conn. Super. Ct. 1977); Ledingham v. Blue Cross Plan, 330 N.E.2d 540, 548–49 (Ill. App. Ct. 1975), *rev'd*, 356 N.E.2d 75 (Ill. 1976); U.S. Fid. & Guar. Co. v. Peterson, 540 P.2d 1070, 1071 (Nev. 1975).

49. STEPHEN S. ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES § 2:15 (2d ed. 1997).

vide grounds for such a claim. The law of contracts provides a cause of action when a party breaches the good faith obligation inherent in all contracts, and the law of torts provides for a claim when a party breaches a common law duty to act in good faith. The contract–tort distinction is significant because practical differences between the two may be very important to claimants. For example, punitive damages are available for tort claims, but unavailable for contract claims.[50] On the other hand, states sometimes require a contract claim to be adjudicated before a tort action can proceed.

In *Comunale*, the California Supreme Court recognized that, while wrongful refusal to settle an insurance claim is generally treated as a tort, when a case sounds in *both* contract and tort the plaintiff may elect between the two.[51] For example, in *Mitchell*, discussed above,[52] the policyholder brought causes of action for breach of contract and for the tort of bad faith rescission of an insurance policy.[53] 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 for the bad faith claim.[54] The insurer filed several post-trial motions, including a motion for the insured to elect remedies.[55] The court granted the insurer's motion and, not surprisingly, the insured elected actual and punitive damages on the bad faith tort cause of action.[56] This demonstrates that the availability of punitive damages provides an incentive for the insured to bring the action in tort in addition to the contract claim.

B. Insurer Duties, Rights, and Obligations Arising from Contract

Aside from handling direct claims from insureds, bad faith concerns also arise related to the insurer's conduct in handling the third party's claim for coverage under an insured's liability insurance policy. In this context, an insured files a claim as a defense to the third party's suit and indemnification for the costs of any

---

50. Freeman & Mills, Inc. v. Belcher Oil Co., 900 P.2d 669, 682 (Cal. 1995) (Mosk, J., concurring in part, dissenting in part).

51. *Comunale*, 328 P.2d at 203.

52. See *supra* text accompanying notes 21–28.

53. Mitchell v. Fortis Ins. Co., 686 S.E.2d 176, 179 (S.C. 2009).

54. *Id.*

55. *Id.* at 182.

56. *Id.*

judgment suffered to compensate the third party.[57] In short, the insured seeks defense to and indemnification from liability to a third party. Thus, the insurer has: (1) a duty to defend a claim even if some or most of the lawsuit is not covered by insurance; and (2) a duty to indemnify—to pay the judgment against the policy holder up to the limit of coverage.[58] As these are contractual obligations, insurers must act with the utmost good faith and fair dealing in determining whether to carry out these duties and ultimately how to do so.[59] A bad faith claim may arise when the insurer breaches either duty.[60] An interesting result emerges due to the nature of the contractual relationship between the insured and the insurer:

> In third-party insurance situations, . . . the insured surrenders to the insurer the right to control and manage the defense of claims made against him. Implicit in the relationship between the insurer and insured is the insurer's duty to play fairly with its insured, or, its duty of good faith. In defending its insured, the duty of good faith requires that the insurer give equal consideration to the protection of the insured's interest as well as its own interest.[61]

Because the right to control the defense—including the right to accept or reject a settlement offer—is assumed by the insurer pursuant to the policy terms, the conflict arises in the duty owed by the insurer to the interests of the insured in deciding whether or not to settle. Most jurisdictions recognize this third duty under the third-party coverage aspect of the policy, which is the duty to settle a reasonably clear claim against the policyholder within the policy limits in order to avoid the risk that the policyholder may be liable

---

57. *See, e.g.*, Sperry v. Sperry, 990 P.2d 381, 383 (Utah 1999) (illustrating that an insurer owes no duty to a third-party claimant).

58. *See* Allstate Indem. Co. v. Ruiz, 899 So. 2d 1121, 1124–31 (Fla. 2005).

59. *Id.* at 1125.

60. *Id.*

61. Med. Protective Co. v. Pang, 606 F. Supp. 2d 1049, 1061–62 (D. Ariz. 2008) (citations omitted).

for a judgment in excess of those limits.[62] This duty is implied in the insurance contract itself, as the insured has given over his rights to the insurance company.[63] Thus, if the insurer breaches one of these duties, it may be liable for the entire amount of any judgment, including an excess judgment.[64]

Justification for imposing the excess judgment liability upon the insurer stems from the duty the insurer drafts for itself in the liability coverage, particularly with regard to the decision to settle the claim.[65] In most cases, the authority to investigate and settle a claim falls to the insurer.[66] For example, the policy language relating to settlements may read, "the company may investigate and settle any claim or suit that [the company] decide[s] is appropriate."[67] The policy will typically both require the insurer to defend the suit and grant the insurer control over any settlement decision.[68] While the general substance is common, there is no uniform language outlining the duties owed or what considerations guide the insurer's discretion in determining whether to settle.[69]

Other provisions outlining the duties of the insurer may focus on the right of the insurer to investigate and settle a claim with no mention of time, thereby leaving this key term unaddressed, as evidenced by language above. This is in contrast to policy provisions which at least mention the imposition of a duty to handle the claim in a timely manner, which could read as follows: "the company may make such investigation, negotiation, and settlement of any claim or suit as it deems expedient."[70] The lack of uniformity in policy provisions inevitably results in various interpretations of

---

62. *See, e.g.*, Hilker v. W. Auto. Ins. Co., 235 N.W. 413, 414 (Wis. 1931) (holding that where an injury arises, and the recovery may exceed the policy, the insurer owes a duty to the insured).

63. *Id.*

64. *See id.* at 414–16.

65. *Id.* at 414–415.

66. Thomas F. Segalla & Brian R. Biggie, *The Unsettling Nature of the Right to Settle Provisions in a Professional Liability Policy*, 59 FED'N DEF. & CORP. COUNS. Q. 31, 31 (2008), *available at* http://www.thefederation.org/documents/V59N1-Segalla.pdf.

67. Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113, 1118–19 (1990) (alterations in original) (internal quotation marks omitted).

68. *Id.*

69. *Id.* at 1118–26.

70. *Id.* at 1132 n.50 (internal quotations marks omitted).

the insurers' duties by separate state courts, which has led to confusion on the part of both insurers and insureds. Nevertheless, it is nearly certain that the insurer will be liable if it fails to respect the interests of the insured by meeting a standard, whether that is a standard of reasonable care or one of good faith.[71]

A key difference exists between the insured's duties to defend and its duty to indemnify. The duty to defend is more extensive than the duty to indemnify.[72] As courts analyze the two duties separately, it is essential to both examine the extent of the duty owed as well as the standard of conduct that will satisfy the insurer's duty.[73] A duty to defend is measured against the possibility of recovery under the claim and exists if the allegations of the complaint might, if proved, trigger the duty to indemnify.[74] However, the duty to indemnify arises only if, as a matter of fact, the damages to the injured party were within the scope of the policy's coverage.[75] Thus, the allegations contained in the pleadings are essentially irrelevant to the insurer's duty of indemnification.[76] This is true "even when a court concludes that 'coverage' applies such that an insurer must defend the insured, a fact-finder may later reach a decision on the disputed facts and conclude that an insurer has no duty to indemnify."[77]

---

71. *See* Goodson v. Am. Standard Ins. Co. of Wis., 89 P.3d 409, 415 (Colo. 2004).

72. Hartford Cas. Ins. Co. v. Merchs. & Farmers Bank, 928 So. 2d 1006, 1009 (Ala. 2005) (per curiam).

73. *See, e.g.*, Tanner v. State Farm Fire & Cas. Co., 874 So. 2d 1058, 1066 (Ala. 2003) (holding that the duty to indemnify must be analyzed separately from the duty to defend, and will be based on the insured's conduct).

74. *See, e.g.*, Frontier Insulation Contractors, Inc. v. Merchs. Mut. Ins. Co., 690 N.E.2d 866, 868–69 (N.Y. 1997) ("The duty of an insurer to defend its insured arises whenever the allegations within the four corners of the underlying complaint potentially give rise to a covered claim . . . .").

75. *See, e.g.*, Med. Care Am., Inc. v. Nat. Union Fire Ins. Co. of Pittsburgh, Penn., 341 F.3d 415, 424 (5th Cir. 2003) (applying Texas law, stating that the court must look to the facts of the underlying litigation to determine if there was a duty to indemnify).

76. *See, e.g.*, Skinner v. Allstate Ins. Co., 127 P.3d 359, 363 (Mont. 2005) (stating that while a company may have to defend their insured, a fact-finder could conclude there is no duty to indemnify based on the disputed facts).

77. *Id.*

C. Types of First-Party and Third-Party Claims

1. First-Party Claims

A first-party payment occurs where an insurance company makes a direct payment to its own insured to recompense the insured for losses suffered.[78] In a first-party claim, therefore, the insured seeks indemnification from the insurer for a loss suffered personally.[79] A first-party claim is based on the fact that "[a]n insurance policy is a contract between the insured and the insurance company."[80] As the implied covenant of good faith and fair dealing inheres in every contract, the insurer's refusal to pay a first-party claim may give rise to claims for both breach of contract and the tort of bad faith.[81] As explained by one court:

> The breach of contractual covenants ordinarily sounds in contract. However, because of the special relationship between an insurer and its insured, the insured may maintain an action to recover tort damages if the insurer, by an intentional act, also breaches the implied covenant by failing to deal fairly and honestly with its insured's claim or by failing to give equal and fair consideration to the insured's interests.[82]

---

78. Sperry v. Sperry, 990 P.2d 381, 383 (Utah 1999). Examples of typical insurance contracts include accident, life, medical payments, disability hospitalization, theft, fire, and uninsured motorist insurances. *First Party Claims/Health/UM/UIM/Auto/Property/Disability*, THE LAW OFFICE OF ROBERT BRUCE ARNOLD, http://www.arnoldlawoffice.com/html/first_party.html (last visited Apr. 13, 2012).

79. *See* George J. Kefalos et al., *Bad-Faith Insurance Litigation in the South Carolina Practice Manual*, S.C. LAW., July–Aug. 2001, at 18, 19, *available at* 13-Aug S.C. LAW 18 (Westlaw).

80. Auto Owners Ins. Co. v. Rollison, 663 S.E.2d 484, 487 (S.C. 2008).

81. *See* Best Place, Inc. v. Penn Am. Ins. Co., 920 P.2d 334, 336–37 (Haw. 1996).

82. Rawlings v. Apodaca, 726 P.2d 565, 579 (Ariz. 1986).

2. Third-Party Claims Creating Excess Liability—Insured Versus Insurer

An excess liability claim arises when the insured is exposed to a judgment that exceeds the policy limits. The development of the excess liability claim has also played a role in the evolution of bad faith claims as it helped courts both determine whether the insurer's failure to settle a claim rises to the level of bad faith and whether there is an adequate remedy for the injured party.[83]

For example, in *Crisci v. Security Insurance Company*, the Supreme Court of California first described the insured's recovery against her insurance company in excess of her policy limits as excess liability.[84] In *Crisci*, the injured third party offered to settle with the insured for the policy limits of $10,000.[85] The insurance carrier, however, refused to settle, and the insured subsequently suffered a judgment at trial for $101,000.[86] The insurer paid to the injured third party the policy limit of $10,000, believing such payment satisfied its obligations pursuant to the contract policy limit.[87] Consequently, the plaintiff–insured filed an action against the insurer for, among other things, the amount by which the judgment exceeded the policy limits caused by the insurer's refusal to settle for the policy limit.[88]

The court found in favor of the insured, rejected the argument that the wrong sounded solely in contract, and reasoned that the remedy should compensate the injured for all damages proximately caused by the wrongdoer and that the breach also constituted a tort.[89] The insurer was thus obligated to pay the excess judgment, or the amount of the judgment by the injured party against

---

83. *See generally* Crisci v. Sec. Ins. Co., 426 P.2d 173 (Cal. 1967) (finding there was sufficient evidence to justify the insured's recovery for breach of the implied covenant of good faith where verdict was in excess of the policy limits because the insurer knew there was a high risk of substantial recovery above the policy limits and it gave more consideration to its financial interests than the financial interests of its insured in refusing to settle the suit for less than the policy limits).

84. *Id.* at 176–77.

85. *Id.* at 175.

86. *Id.* at 176.

87. *Id.*

88. *Id.* at 175.

89. *Id.* at 176–79.

the insured in excess of the policy limits, because of the insurer's failure to appropriately consider the insured's interests.[90] To determine whether the insurer appropriately considered those interests, the court asked whether a prudent insurer without policy limits would have accepted the settlement offer.[91] The defendant was faced with two options, either: (1) reject the settlement offer and risk a judgment in excess of the policy limits; or (2) accept the settlement offer within the policy limits.[92] By failing to take the latter course, the insurer breached the implied duty of good faith and fair dealing.[93]

Thus, where an insurer receives an offer to settle within the policy limits and rejects it, the insurer may be liable for the amount of a final judgment whether or not it is within policy limits.[94] A judgment in excess of the policy limits provides an inference, while not conclusive, that acceptance of the offer within the limits was the most reasonable method of dealing with the claim.[95] Moreover, if the refusal to settle is unreasonable, it may also give rise to a bad faith claim.[96]

Therefore, the concept of the excess liability claim is closely tied to the "duty to settle." This further helps to define and outline the duties of the insurer with regard to its treatment of its insureds. Once the insurer assumes 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 interest on equal footing with its own.[97] 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.[98] The result is that an insurer's failure to properly carry out this duty often gives rise to a bad faith claim. The question remains, however, as to what constitutes "properly carry out" in terms of the duty to settle a rea-

---

90. *Id.* at 177–78.
91. *Id.* at 176.
92. *Id.* at 175–77.
93. *Id.* at 178.
94. *Id.* at 176–77.
95. *Id.* at 176–77.
96. *See id.*
97. *Id.* at 176.
98. *See, e.g.*, Frontier Insulation Contractors, Inc. v. Merch. Mut. Ins. Co., 690 N.E.2d 866, 868–70 (N.Y. 1997).

sonably clear claim. Thus, is a "delay" sufficient to trigger a bad faith claim?

Additionally, there is a trend among a few states that in order to bring a bad faith claim, there must be a resolution of the underlying claim and an excess judgment. In jurisdictions that have considered the issue, often a claim for bad faith does not accrue until there has been a final determination of the underlying claim for insurance benefits or third-party damages.[99] The judgment is considered "excess" where its total amount exceeds the limitation of coverage under the insurance policy. How each state addresses this issue will assist in determining where the state should be categorized according to the *Three Little Pigs* analogy.

3. Third-Party Claims Creating Excess Liability—Third-Party Versus Insurer

Generally, there is no direct third-party action for bad faith against the insurer due to the lack of privity of contract between the insurer and the third party. The duty of good faith and fair dealing only arises out of the contractual relationship between the insured and the insurer.[100] However, South Carolina and Florida are two of the states that provide *some* form of remedy for an aggrieved third party, albeit not necessarily one for bad faith.[101] For example, the South Carolina Supreme Court recognized a tort action for a third-party claim directly against the insurer for fraudulently inducing the third party to sign a release.[102] Clearly, this is not a bad faith cause of action. Nonetheless, a third-party claim is an available alternative in South Carolina when the insurer engages in fraud and misrepresentation when dealing with the third-party claimant. Few states allow such a claim.

---

99. Taylor v. State Farm Mut. Auto. Ins. Co., 913 P.2d 1092, 1095–96 (Ariz. 1996); Blanchard v. State Farm Mut. Auto. Ins. Co., 575 So. 2d. 1289, 1291 (Fla. 1991).

100. *See generally* Gaskins v. S. Farm Bureau Cas. Ins. Co., 581 S.E.2d 169, 170–71 (S.C. 2003) (holding that in order to prove materiality element of the tort of fraud, the insured must prove the insurer had an obligation to pay by alleging and proving the liability of the tortfeasor. This obligation to pay comes from the contract between the insured and insurer.).

101. *See id.*; *see also* FLA. STAT. ANN. §624.155 (West 2004 & Supp. 2012).

102. *Gaskins*, 581 S.E.2d at 170–71.

As distinguished from South Carolina, most states, including California, hold that a third-party claimant cannot bring an action upon a duty owed to the insured absent an assignment.[103] Direct claims by third parties are generally brought under a common law tort action.[104] The states that permit a third party to bring a bad faith action against an insurer via an assignment of the first party's rights recognize the importance of offering the third party some protection similar to that of the first-party claimant.[105] Louisiana provides for a direct action by third parties under the Civil Law of the state.[106] Florida is the only state that allows the third-party claimant to bring a direct action for bad faith against an insurer under a statutory provision without the privity of contract requirement.[107] These varied approaches form the basis of the analogy of this Article regarding the opportunities available to the two distinct types of claimants—first parties and third parties.

Assignment is an important means by which a third party may make a bad faith claim against an insurer. This situation arises when an insured person causes a loss to a third party who subsequently sues the insured and receives a judgment exceeding the policy limit.[108] The insured may assign his cause of action to the third party so that the third party can recover directly from the insurance company.[109] Generally, a third party's right to sue may arise via one of the following: (1) an assignment from the insured

---

103. Jane D. v. Ordinary Mut., 38 Cal. Rptr. 2d 131, 135 (Cal. Ct. App. 1995).

104. *See* Pontchartrain Gardens, Inc. v. State Farm Gen. Ins. Co., No. 07-7965, 2009 U.S. Dist. LEXIS 3734, at *9–11 (E.D. La. Jan. 13, 2009); Bd. of Trs. of Mich. State Univ. v. Cont'l Cas. Co., 730 F. Supp. 1408, 1411–12 (W.D. Mich. 1990); Liberty Mut. Ins. Co. v. Farm, Inc., 754 So. 2d 865, 866 (Fla. Dist. Ct. App. 2000).

105. *See* MICH. COMP. LAWS ANN. § 500.2006 (West 2002 & Supp. 2011); Williams v. State Farm Mut. Auto. Ins. Co., 886 So. 2d 72, 75–76 (Ala. 2003) (applying Alabama law); Allstate Indem. Co. v. Ruiz, 899 So. 2d 1121, 1125 (Fla. 2005) (applying Florida law); Simmons v. Puu, 94 P.3d 667, 677–78 (Haw. 2004) (recognizing in Hawaii a claim for third-party assignment only).

106. *See Pontchartrain Gardens*, 2009 U.S. Dist. LEXIS 3734, at *8–14.

107. FLA. STAT. § 624.155 (West 2004 & Supp. 2012).

108. *See Simmons*, 94 P.3d at 673–78 (recognizing a claim for third-party assignment only).

109. *Id.*

to the injured party of the insured's rights against the insurer;[110] (2) a statutory cause of action;[111] or (3) a policy provision authorizing the suit.[112] To incentivize insureds to assign their bad faith claim, the third party typically conveys consideration in the form of agreeing not to levy against the insured's personal assets.[113] The third party then "steps into the shoes" of the insured as the plaintiff and sues the defendant insurance company for bad faith.[114] In South Carolina, the "*Tyger River* Doctrine," so named for *Tyger River Pine Co. v. Maryland Casualty Insurance Co.*, established the third party bad faith claim and the requisite elements to assign the insured's rights.[115] To succeed, the third party must show: (1) the insurer had an opportunity to settle the case against the insured for an amount within the policy limits; and (2) the insurer acted in bad faith in failing to settle resulting in damage to the insured.[116] These judicially created doctrines offer alternative routes which provide aggrieved third parties an opportunity to seek recovery for delays or failures in the settling of claims for their treatment.

---

110. Moutsopoulos v. Am. Mut. Ins. Co. of Bos., 607 F.2d 1185, 1189 (7th Cir. 1979).

111. Greer v. Mid-West Nat'l Fire & Cas. Ins. Co., 434 F.2d 215, 217 (8th Cir. 1970).

112. Vaughn v. Vaughn, 597 P.2d 932, 934 n.3 (Wash. Ct. App. 1979).

113. Kefalos, *supra* note 7979, at 21–22.

114. *See generally* Murphy v. Allstate Ins. Co., 553 P.2d 584, 587–90 (Cal. 1976) (holding that a third party can only enforce a contract expressly made for his benefit and cannot sue the insurer directly). The court said "[A third party] is not a contracting party; his right to performance is predicated on the contracting parties' intent to benefit him." *Id.* at 588. Therefore, a third party can only recover against the insurer if the contracting party provides him a method of procuring such benefits through an assignment. *Id.* at 590.

115. Tyger River Pine Co. v. Md. Cas. Ins. Co., 170 S.E. 346 (S.C. 1933); Kefalos, *supra*, note 7979, at 21–22. Other states have similar doctrines with names such as the "Texas *Stowers* Doctrine." G.A. Stowers Furniture Co. v. Am. Indem. Co., 15 S.W.2d 544 (Tex. Comm'n App. 1929); *see also* Willy E. Rice, *Questionable Summary Judgments, Appearances of Judicial Bias, and Insurance Defense in Texas Declaratory-Judgment Trials: A Proposal and Arguments for Revising Texas Rules of Civil Procedure 166a(a), 166a(b), and 166a(i)*, 36 ST. MARY'S L.J. 535, 615 (2005).

116. *See generally Tyger River Pine Co.*, 170 S.E. 346 (holding that an insurer who assumes the duty of defending a claim has a duty to settle if it is the reasonable thing to do). Here, the insurer failed to reasonably settle the claim. *Id.* at 349.

4. Declaratory Judgment Actions and Bad Faith

Declaratory judgment actions represent an area in which the conflict between the insurer and insured is ostensibly apparent and these often give rise to bad faith claims. This action involves the insurer taking the precautionary step of bringing a declaratory judgment action against the insured for a safe determination of any issues that would be determinative of coverage or of its obligation to defend.[117] However, the unintended consequence of a declaratory judgment action is that such a proceeding requires the insured to file a responsive answer to the allegations.[118] In addition to the answer, the insured is often compelled to file any and all counterclaims, including a counterclaim for bad faith for forcing the insured to defend an action he or she believes is covered by the language of the policy.[119] Interestingly, rather than resolving the conflict between insurer and insureds, the consequence of the insurer seeking the declaratory judgment may, in fact, result in an increase in bad faith filings at a particularly early stage in the process and investigation of the claim.

5. Reservation-of-Rights Letters & Heightened "Good Faith"

Reservation-of-Rights letters raise important issues related to bad faith, particularly in outlining an insurer's duties.[120] In a typical scenario, the insurer sends the letter to the insured on the insurer's undertaking of the insured's defense of a third-party claim and explicitly states that by undertaking the insured's de-

117. *See generally* Edwin M. Borchard, *Declaratory Judgments and Insurance Litigation*, 34 ILL. L. REV. 245 (1939) (stating the importance of the declaratory judgment action in insurance litigation).

118. FED. R. CIV. P. 12(a)(1)(A).

119. FED. R. CIV. P. 13(a)(1).

120. *See generally* 44 AM. JUR. 2D *Insurance* § 1416 (2003) (stating that "[w]here an insured refuses to consent to a defense under a reservation of rights, the insurer must thereupon give the insured proper unilateral notice of its reservation of rights, take the necessary steps to prevent the main action from going into default or to prevent the insured from being otherwise prejudiced, and seek immediate declaratory relief including a stay of the main case pending a final resolution of the declaratory judgment action").

fense, the insurer is not waiving its right to contest the coverage.[121] In other words, the letter unilaterally reserves the insurer's right to deny coverage following the commencement of the defense.[122] It is important for the insurer to realize that where "an insurance company undertakes a defense pursuant to a reservation of rights, it does so under an enhanced obligation of good faith toward its insured in conducting such a defense."[123] This heightened good faith standard is rooted in the contractual relationship between the insurer and the insured, but arises out of the duty owed in response to the third-party claim.[124] One court noted when comparing the "normal tripartite relationship between the insurer, the insured, and the defense attorney [retained by the insurer]," that where there is a conflict of interest, the retained attorney's primary obligation is to the insured.[125] This obligation remains with the insured even where there is a conflict, such as when the insurer retains its right to contest coverage under the policy.[126]

Generally, to satisfy the heightened good faith requirement, the insurer must: (1) thoroughly investigate; (2) retain sufficiently competent defense counsel who is aware that *only the insured is the client*, not the insurer; (3) inform the insured of the defense and any and all developments pertinent to his coverage under the policy and the progress of the lawsuit; and (4) avoid any action that would demonstrate a greater concern for the insurer's own monetary interest than for the insured's financial risk.[127] In addition to the above requirements, the retained defense counsel has a duty of

---

121. United Nat'l Ins. Co. v. Waterfront N.Y. Realty Corp., 948 F. Supp. 263, 268 (S.D.N.Y. 1996).

122. *Id.*

123. Twin City Fire Ins. Co. v. Colonial Life & Accident Ins. Co., 839 So. 2d 614, 616 (Ala. 2002) (quoting Aetna Cas. & Sur. Co. v. Mitchell Bros., Inc., 814 So. 2d 191, 195 (Ala. 2001)) (internal quotation marks omitted).

124. *Id.*; *see* Lifestar Response of Ala., Inc. v. Admiral Ins. Co., 17 So. 3d 200, 218–19 (Ala. 2009) (noting that plaintiff's claim against defendant for failure to investigate the underlying action implicates the enhanced obligation of good faith, which is a breach of contract claim).

125. *Lifestar Response*, 17 So. 3d at 216–17.

126. *Id.* at 217.

127. L & S Roofing Supply Co. v. St. Paul Fire & Marine Ins. Co., 521 So. 2d 1298, 1303–04 (Ala.1987) (adopting the view of the Washington Supreme Court in Tank v. State Farm Fire & Casualty Co., 715 P.2d 1133, 1137 (Wash. 1986)).

full and ongoing disclosure to the insured.[128] Within this duty is the requirement that the insured's defense counsel must keep the insured fully apprised of all activity involving settlement. This is paramount, because in a reservation-of-rights defense, it is the insured who may pay any judgment—or even the settlement—if coverage is later denied.[129] Thus, any failure of the above on the part of the insurer may give rise to a bad faith claim.

With an understanding of the duties at the heart of bad faith claims and the context in which bad faith claims arise, we return to the analogy of *The Three Little Pigs.*

IV. THE THREE LITTLE PIGS AND BUILDING THE BAD FAITH INSURANCE HOUSE

The dwelling materials in *The Three Little Pigs* story symbolize the different levels of protection offered by states through their interpretation, definition, and application of bad faith. The distinctions are significant not only in the ability of claimants to bring different types of claims, but also in the remedies available for various types of behaviors. The factors considered in evaluating each of the fifty states include: whether the state provides for a tort action; whether the state provides for a contract claim; what, if any, statutory provisions and damages are available to claimants; whether those statutes extend rights of action to either first-party or third-party claimants, or both; and the availability of punitive damages for bad faith claims. Attempting to apply distinct categories is imprecise, as states sometimes do not fit neatly into each group.

It is important to note that federal courts often interpret state insurance laws when considering insurance law cases. This Article attempts to categorize state insurance laws. In providing this fifty state survey, scholars, practitioners, and insurance companies operating in various states can use this survey as an outline as to their state's approach to bad faith. The best guidance we have is an analysis of judicial opinions to date and some of those include opinions from federal courts interpreting state law. Precedential value of these opinions will vary depending upon the amount of deference afforded by any state court of the highest au-

128. *Id.* at 1303.
129. *Id.*

thority reviewing the same; but, in the absence of other decisions on particular issues, these cases provide guidance to the state's approach. Therefore, some federal opinions are included in this survey for that purpose.

A. Houses of Straw

"Houses of Straw" are represented by states that, like the fairy tale, offer the least amount of protection to a potential claimant. In short, these are states that have applied the narrowest definition of bad faith to cases involving the actions or inactions of insurers in the handling of claims. States that are classified under this definition of "Straw" as used in this analogy are Georgia, Illinois, Kansas, Maine, Maryland, Missouri, New York, Oregon, Pennsylvania, Tennessee, Utah, and Virginia. These states have the common elements of either providing no private right of action for claimants, no recognition of an action in tort for bad faith,[130] or have limited rights of action in tort. The significance of these limitations is reflected in the ability or inability to recover particular damages.[131] As stated earlier, when a right of action in tort is prohibited, punitive damages are not available to the claimants. In these "Straw" states, the claim of bad faith sounds primarily in contract.

Georgia

Beginning with Georgia, in *Tate v. Aetna Casualty & Surety Co.*, the Georgia Court of Appeals affirmed the trial court's grant of summary judgment on an insured's negligence claim in an action by an insured for damages arising from a fire in a house insured by the insurer–defendant.[132] The court reasoned that the relationship between the insurer and the insured was contractual, and a mere breach of a valid contract ordinarily did not constitute a

130. *See, e.g.*, Tate v. Aetna Cas. & Sur. Co., 253 S.E.2d 775 (Ga. Ct. App. 1979) (holding no tort of bad faith in Georgia); Cramer v. Ins. Exch. Agency, 675 N.E.2d 897 (Ill. 1996) (finding no separate cause of action in tort); Anderson v. S. Sur. Co., 191 P. 583 (Kan. 1920) (holding the insurer liable for damages which are shown to result from its own negligence).

131. *See, e.g.*, Marquis v. Farm Family Mut. Ins. Co., 628 A.2d 644 (Me. 1993) (holding that contract remedies and statutory provisions protected insureds from the bad faith actions of insurers).

132. *Tate*, 253 S.E.2d at 776–77.

tort.[133] The insured sought damages for the insurer's negligence in violating industry and ethical standards, using an unlicensed adjuster, committing an unfair business practice, and failing to properly inspect the losses and property.[134] The court recognized that "misfeasance in the performance of a contractual duty may give rise to a tort action" but only if the injury to the plaintiff is independent from the plaintiff's disappointment in not receiving the benefit of the contract.[135] Further, the court held that the insurer's duties arose only from the parties' contract and not out of any statute; therefore, the insured's damages were limited to those authorized in the "bad faith" provisions of another statute.[136] That statute provided that the claimant's damages for bad faith were limited to the loss, plus the greatest of not more than fifty percent of the insurer's liability for the loss or $5000, plus all reasonable attorneys' fees.[137] In doing so, Georgia limited the ability of claimants to bring actions in tort arising from the actions of insurers in adjusting claims to those in which the injury is independent from the failure to obtain the benefit of the contract.[138] However, an insured in Georgia is not without recourse. As stated above, the legislature explicitly provided a statutory cause of action for a breach of the implied duty of good faith and fair dealing.[139] Due to the tort limitation on claimants' abilities to bring bad faith actions and limitations of damages available under the statute, Georgia qualifies as a "Straw" state, i.e., one of limited protections.

Illinois

Illinois is an example of a state with a complicated approach to bad faith. Illinois does not recognize the existence of a separate tort action for bad faith. However, an insurer can be pe-

133. *Id.* at 777 (citing Mauldin v. Sheffer, 150 S.E.2d 150, 153 (Ga. Ct. App. 1966)).

134. *Id.* at 776.

135. *Id.* at 777 (quoting Long v. Jim Letts Oldsmobile, Inc., 217 S.E.2d 602, 604 (Ga. Ct. App. 1975)).

136. *Id.*

137. GA. CODE ANN. § 33-4-6 (2000 & Supp. 2011); *see also* GA. CODE ANN. § 33-4-7 (Supp. 2011) (providing for the same damages in a "bad faith" claim in the context of motor vehicle liability insurance).

138. *Tate*, 253 S.E.2d at 777; *see* GA. CODE ANN. § 33-4-6.

139. *See* GA. CODE ANN. § 33-4-6.

nalized under a statutory provision if its delay in paying a claim is deemed to be "vexatious and unreasonable."[140] Nonetheless, Illinois law permits insureds to assign their rights to pursue claims to third parties. In *Mid-America Bank & Trust Co. v. Commercial Union Insurance Co.*, the ward of the plaintiff suffered severe injuries after being hit by a truck.[141] The plaintiff offered to settle for $50,000, but the insurer's attorney offered only "$30,000, take it or leave it," without consulting with the insured truck driver.[142] In an action against the truck driver, the jury awarded in excess of $900,000.[143] The truck driver assigned his claims against the insurer to the plaintiff in exchange for a covenant not to execute the judgment against him.[144] The court held there was evidence that the insurer acted negligently or in bad faith because the insurer was aware of the extent of the injuries and the risk of excess liability judgment and refused to settle within the policy limits.[145] The significance of the case is found in the determination that negligence is sufficient to establish bad faith under Illinois law, as well as in the ability of the claimant to receive an assignment of the insured's right for the excess judgment and proceed with a bad faith action against the insurer. These provisions together provide some protection, albeit not as extensive as other states, for the insured and the third-party claimant, putting Illinois in the category of a "Straw" state.

---

140. 215 ILL. COMP. STAT. 5/155 (West 2000 & Supp. 2011); *see also* Cramer v. Ins. Exch. Agency, 675 N.E.2d 897, 904 (Ill. 1996) ("Mere allegations of bad faith or unreasonable and vexatious conduct, without more, however, are not sufficient to constitute [an independent] tort.").

141. Mid-Am. Bank & Trust Co. v. Commercial Union Ins. Co., 587 N.E.2d 81, 82 (Ill. App. Ct. 1992), *limited by* Stevenson v. State Farm Fire & Cas. Co., 628 N.E.2d 810, 813 (Ill. App. Ct. 1993) (limiting *Mid-America* to its facts and stating it is not the rule where the question of insurance coverage is at issue.) The court stated that where the insurance company "can reasonably examine a set of facts and determine that the incident or occurrence which is the substance of the underlying controversy is not one contemplated by the policy, then it does not owe the same kind of duty as that required by . . . *Mid-America*." *Stevenson*, 628 N.E.2d at 813.

142. *Mid-America Bank & Trust Co.*, 587 N.E.2d at 82 (internal quotation marks omitted).

143. *Id.* at 82–83.

144. *Id.* at 83.

145. *Id.* at 83–84.

Kansas

In Kansas, *Spencer v. Aetna Life & Casualty Insurance Co.* directly addressed the question of whether the state recognized an independent tort of bad faith.[146] In a case involving an aggrieved insured in a first-party relationship, the Supreme Court of Kansas held that Kansas did not recognize the independent tort of bad faith because the legislature had provided numerous and adequate statutory remedies for problems created by an insurer.[147] However, when addressing bad faith claims under the Kansas statutes, the court had previously stated that insurers not only have a duty of good faith, they also have a duty to act without negligence.[148] In Kansas, the insurer has a duty to consider the interests of the insured and the insurer's own interests equally. The insurer cannot put its own interests above those of the insured. More recently, the Kansas Court of Appeals stated that the insurer must "'evaluate[] a claim without looking to the policy limits and as though it alone would be responsible for the payment of any judgment rendered on the claim.'"[149] Thus, a bad faith insurance claim under Kansas law arises when an insurer refuses or fails to pay for a claim or is negligent in defending its insured. The Supreme Court of Kansas in *Spencer* did however distinguish first-party relationships from third-party claimants stating that the control of third-party claims was at the insurer's discretion.[150] That control, which gave rise to a fiduciary duty in the insurer, was not present in a first-party situation where the parties had an adversarial relationship.[151] As a result, Kansas permits a bad faith action in contract but rejects an

146. Spencer v. Aetna Life & Cas. Ins. Co., 611 P.2d 149 (Kan. 1980).

147. *Id.* at 156–58.

148. *Id.* at 155 (applying the duty to act without negligence to third-party claims); *see* Bollinger v. Nuss, 449 P.2d 502, 508 (Kan. 1969) (agreeing with "the vast majority of cases," finding a duty to settle a policy in good faith within the policy limits and that a negligence standard would suffice); Anderson v. S. Sur. Co., 191 P. 583 (Kan. 1920) (concluding the insurer will be liable for damages which are shown to result from negligence of the insurer).

149. Levier v. Koppenheffer, 879 P.2d 40, 46 (Kan. Ct. App. 1994) (quoting *Bollinger*, 449 P.2d at 511).

150. *Spencer*, 611 P.2d at 155.

151. *Id.*

action in tort, even for first-party claimants.[152] Additionally, in *Glenn v. Fleming*, the Kansas Supreme Court held that an insured's breach of contract claim for bad faith or negligent refusal to settle may be assigned, but that assignment did not extend to a tort action, as Kansas does not recognize the tort of bad faith.[153] As a result, Kansas qualifies as a "Straw" state.

Maine

Similarly, in Maine, the Maine Supreme Court determined that the tort claim of bad faith does not exist under state law.[154] In *Marquis v. Farm Family Mutual Insurance Co.*, the court held that contract remedies and statutory provisions protected insureds from the bad faith actions of insurers.[155] In the case, the court found that the plaintiffs had failed to plead unfair claims practices under the Maine statute, which may have provided statutory protection where common law tort protections were not recognized.[156] Therefore, while Maine does not recognize a tort claim for bad faith, it has enacted statutory provisions that provide some protections for first-party claimants for the unfair settlement practices of insurers.[157] Unfortunately, Maine does not provide many avenues of relief for third-party claimants.[158] Additionally, Maine rejected legislation which would have created a private right of action for anyone alleging a violation of Maine's Unfair Claims Practices statute.[159] As a result, Maine is also considered a "Straw" state for offering lower protections to claimants than other states.

Maryland

---

152. Guarantee Abstract & Title Co. v. Interstate Fire & Cas. Co., 652 P.2d 665, 667–68 (Kan. 1982) (citing *Spencer*, 611 P.2d at 155).

153. Glenn v. Fleming, 799 P.2d 79, 89 (Kan. 1990).

154. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d 644, 652 (Me. 1993).

155. *Id.*at 652.

156. *Id.* at 651–52.

157. ME. REV. STAT. ANN. tit. 24-A, § 2436-A (2000).

158. *See* Stull v. First Am. Title Ins. Co., 745 A.2d 975, 981(Me. 2000) (recognizing that any tort recovery by a third party to the insurance contract must be based upon conduct independent of the breach of contract).

159. ME. REV. STAT. ANN. tit. 24-A, § 2164-D(8) (2000); H.P.0908, LD-1305, 124th Leg., 1st Reg. Sess. (Me. 2009).

In Maryland, in *Johnson v. Federal Kemper Insurance Co.*, the Maryland Court of Special Appeals also rejected the tort of bad faith.[160] The plaintiff in *Johnson* argued that the legislature had signaled its recognition of an independent cause of action for bad faith when it passed a statute regulating unfair claims practices.[161] The court found that the existence of the statute ran directly counter to plaintiff's argument for a tort action.[162] Instead of providing for a separate cause of action, the statute reflected the state's decision to address abuses within the insurance industry for the public good, rather than by rewarding or providing additional compensation to individual plaintiffs.[163] Taken together, the court held, a traditional contract action addressed the expectations of the plaintiff, while the fines and other penalties assessed by the state addressed the public interest in modifying future insurer behavior.[164] As a consequence, the court declined to recognize a specific tort action against an insurer for a bad faith failure to pay an insurance claim.[165]

However, more recently in *Cecilia Schwaber Trust Two v. Hartford Accident and Indemnity Co.*, the insured brought an action for breach of the insurance contract and "failure to act in good faith in paying an insurance claim."[166] The insurer moved for summary judgment as to the insured's claim because at the time of the original action, Maryland did not provide insureds with a first-party claim for such failure.[167] Since that time, however, Maryland enacted a statute creating such a claim.[168] The insurance policy at issue in the case covered the years 2002 and 2003, but the court determined that the legislative history and statutory text were sufficient to show that the legislature intended for the statute to apply

---

160. Johnson v. Federal Kemper Ins. Co., 536 A.2d 1211, 1212–13 (Md. Ct. Spec. App. 1988).

161. *Id.* at 1213.

162. *Id.*

163. *Id.* (noting the statute deemed this "administrative relief").

164. *Id.* at 1213–14.

165. *Id.*

166. Cecilia Schwaber Trust Two v. Hartford Accident and Indem. Co., 636 F. Supp. 2d 481, 482 (D. Md. 2009).

167. *Id*. at 483.

168. MD. CODE ANN. INS. § 27-1001 (LexisNexis 2011).

retroactively.[169] As a result of the enactment of the statute, Maryland does provide first-party claimants a right of redress for improper or unfair claims practices, albeit with limited damages. Nevertheless, because Maryland still does not recognize a tort action for bad faith and limits damages, Maryland is classified as a "Straw" state.

Missouri

Missouri has a complicated overlap of statutory provisions and case law. One of the most common reasons for bringing a bad faith claim against an insurer arises when the insurer has an opportunity to settle a claim against the insured and fails to do so. Missouri courts have defined the elements for this bad faith claim under state law as:

> (1) the liability insurer has assumed control over the negotiation, settlement, and legal proceedings brought against the insured; (2) the insured has demanded that the insurer settle the claim brought against the insured; (3) the insurer refuses to settle the claim within the liability limits of the policy; and (4) in so refusing, the insurer acts in bad faith, rather than negligently.[170]

Control of the defense and settlement of the claim are important elements. More specifically, Missouri defines bad faith as when a company refuses:

> to settle within its policy limits when it attempt[s] to escape its obligations under the policy by an *intentional* disregard of the financial interests of the insured . . . [and] when the company attempt[s] to force the insured to contribute money to a settlement within the limits of the policy or where it appear[s] that the company prefer[s] to gamble on es-

169. *Cecilia*, 636 F. Supp. 2d at 488–90.

170. Bonner v. Auto. Club Inter-Ins. Exch., 899 S.W.2d 925, 928 (Mo. Ct. App. 1995) (quoting Dyer v. Gen. Am. Life Ins. Co., 541 S.W.2d 702, 704 (Mo. Ct. App. 1976)).

> caping all liability by a favorable verdict rather than accept a reasonable settlement within policy limits.[171]

Therefore, under Missouri law, bad faith is shown by "the failure of the [insurance] company to act honestly to save the insured harmless as it has contracted to do in its policy."[172] Good faith requires the insurance company to settle within the policy limits as "honest judgment and discretion dictates."[173] In distinction from other states, under Missouri law, the tort of bad faith is limited and rests on the insurer's fiduciary duty to the insured that arises from the insurer's assumption of control over the insured's defense in the underlying litigation.[174] Therefore, the tort arises only after the insurer assumes the duty of defense in the action.

Additionally, Missouri provides some protections through statutory provisions where a first-party claim can be brought as a "vexatious refusal to pay."[175] Nonetheless, not every first-party insurance claim, even those in which the insured prevails, results in an award of vexatious penalties. There are certain elements under the statute that must be proven by the insured bringing the action to win vexatious refusal damages. The insured has the burden to show that "the insurer's refusal to pay [was] willful and without reasonable cause, as the facts would appear to a reasonable and prudent person."[176] One scholar noted that examples of situations where vexatious refusal penalties were awarded include the following:

> 1. Refusal to pay based on a suspicion that is unsupported by substantial facts;

---

171. Landie v. Century Indem. Co., 390 S.W.2d 558, 563 (Mo. Ct. App. 1965) (citing Zumwalt v. Utils. Inc. Co., 228 S.W.2d 750 (Mo. 1950)) (emphasis added).

172. *Id.*

173. *Id.*

174. *Bonner*, 899 S.W.2d at 928.

175. MO. ANN. STAT. §§ 375.296, 375. 420 (West 2002); Mears v. Columbia Mut. Ins. Co., 855 S.W.2d 389, 392 (Mo. Ct. App. 1993).

176. *Mears*, 855 S.W.2d at 394 (citing MO. ANN. STAT. § 375.296; MO. ANN. STAT. § 375.420).

> 2. Persistence in refusal to pay after insurer becomes aware that it has no meritorious defense;
>
> 3. Refusal to pay based on an inadequate investigation and a denial of liability without stating a ground for denial;
>
> 4. Refusal to pay founded not on what appeared to be the facts, but on a possibility that later investigation would develop facts justifying a refusal to pay, even if such investigation did develop such facts.[177]

In Missouri, a third-party claimant has no direct right to sue the insurer for bad faith because this right belongs to the insured; once the insured assigns that right to a third party, however, the third party, as an assignee, may bring the claim.[178] In *Johnson v. Allstate Insurance Co.*, Missouri permitted such an assignment.[179] This case involved third-party claimants who were injured by a drunk driver.[180] The claimants suffered severe injuries but offered to settle their claims against the tortfeasor and his insurance company for the policy limits.[181] The insurer failed to respond to the demand.[182] The Missouri Court of Appeals held that

> [the insurer's] failure to recognize the severity of the [plaintiffs'] injuries and the probability that the claim would far exceed [the tortfeasor's] policy limits; its failure to investigate the claim and respond to the demand in accordance with insurance industry standards and its own good faith claim handling manual . . . all . . . support[ed] a reasonable inference that [the insurer's] refusal to settle was in bad faith.[183]

---

177. Anthony G. Fussner, Comment, *Overview of Bad Faith Litigation in Missouri*, 62 MO. L. REV. 807, 812 (1997).

178. *See* MO. ANN. STAT. § 537.065 (West 2008).

179. Johnson v. Allstate Ins. Co., 262 S.W.3d 655 (Mo. Ct. App. 2008).

180. *Id.* at 658–61.

181. *Id.* at 660.

182. *Id.*

183. *Id.* at 665.

This case is an excellent example of an assignment of an insured's claim for bad faith against an insurer to third-party claimants permitted under Missouri law. Additionally, *Johnson* suggests that there is a requirement that the insurer undertake the defense of the insured as a condition precedent to assignment.[184] So, while Missouri does recognize a tort for bad faith, a third party seeking to pursue a bad faith claim via assignment may be limited to situations when the insurer has first undertaken the defense of the insured. The uncertainty regarding the necessity of the condition precedent—the insurer's undertaking the insured's defense—as well as other limitations, results in Missouri being categorized as a "Straw" state.

New York

In New York, a recent case addressed the issue of bad faith in an action between an insured and its insurer where the underlying plaintiff settled with both in excess of the policy limits.[185] In *CBLPath, Inc. v. Lexington Insurance Co.*, the insurer paid its policy limits and the insured paid the balance, who then brought a bad faith claim against the insurer for failing to settle the claim within the policy limits.[186] The appellate court found that the insured's claim could not stand because it failed to raise a triable issue of fact as to whether the underlying plaintiff made a pre-litigation settlement demand within the policy limits.[187] In addition, the insured could not show that it lost an opportunity to settle because of the insurer's conduct, and therefore any damages would be specu-

184. *See id.* at 662 ("An insurer that assumes control of the right to settle claims against its insured may become liable in excess of the policy limits if it fails to exercise good faith in considering an offer to compromise the claim for an amount within the policy limits."); *see also* Dyer v. Gen. Am. Life Ins. Co., 541 S.W.2d 702, 704 (Mo. Ct. App. 1976) (indicating that for a bad faith failure to settle claim to exist, the insurer must first assume control of the defense of the claim against the insured). Thus, it logically follows that if the insurer must assume control of the defense for the claim to exist, it must also assume control of the defense for an assignment to occur. In other words, the claim must *exist*, before the assignment of the claim can occur.

185. CBLPath, Inc. v. Lexington Ins. Co., 900 N.Y.S.2d 462, 464 (N.Y. App. Div. 2010).

186. *Id.*

187. *Id.* at 465.

lative.[188] New York does recognize the right of the first-party claimant to bring an action in contract for bad faith; however, it does not recognize an independent tort for bad faith.[189] Also, New York permits an award of punitive damages, but only after the plaintiff has made a showing of "egregious tortious conduct" towards the insured and "a pattern of similar conduct directed at the public generally."[190] Therefore, due to New York's lack of clarity in adopting a tort for bad faith, it is considered a "Straw" state.

Oregon

Like Missouri and a few other states, bad faith liability in third-party claims under Oregon law generally only arises where the liability carrier assumed the defense of the insured.[191] The insurer is not liable in tort to its insured for failing to properly defend the insured where the insurer did not assume the defense of the third-party claim.[192] Moreover, Oregon has generally limited an insurer's liability to its insured in first-party insurance claims to

188. *Id.* at 465–66.

189. *See, e.g.*, Polidoro v. Chubb Corp., 386 F. Supp. 2d 334, 337 (S.D.N.Y. 2005) ("[N]o tort duty of care flows to the insured separate from the insurance contract."); Cont'l Cas. Co. v. Nationwide Indem. Co., 792 N.Y.S.2d 434, 435 (N.Y. App. Div. 2005) (dismissing counterclaim as there is no separate cause of action in tort for an insurer's bad faith failure to perform its obligations under the policy); Royal Indem. Co. v. Salomon Smith Barney, Inc., 764 N.Y.S.2d 187, 188 (N.Y. App. Div. 2003) ("Allegations that an insurer had no good faith basis for denying coverage are redundant to a cause of action for breach of contract based on the denial of coverage, and do not give rise to an independent tort cause of action, regardless of the insertion of tort language into the pleading.").

190. Rocanova v. Equitable Life Assurance Soc'y, 634 N.E.2d 940, 944 (N.Y. 1994).

191. *See* Georgetown Realty, Inc. v. Home Ins. Co., 831 P.2d 7, 13–14 (Or. 1992). Through discussion of *Maine Bonding & Casualty Co. v. Centennial Insurance Co.*, 693 P.2d 1296 (Or. 1985), the court explained that the third party's claim against the insurer arises out of the insurer's duty to meet the ordinary standard of care when defending their insured. *Georgetown Realty*, 831 P.2d at 13–14. The court explained that "the insurer's conduct would be actionable 'negligence' toward the [third-party] if it were actionable negligence toward the insured." *Id.* at 14.

192. Farris v. U.S. Fid. & Guar. Co., 587 P.2d 1015, 1018–19 (Or. 1978); Warren v. Farmers Ins. Co., 838 P.2d 620, 623–24 (Or. Ct. App. 1992).

breach of contract damages, even where the insurer violated Oregon's Unfair Claims Settlement Act.[193] The Oregon Supreme Court summarized the limitations on bad faith liability in *Farris v. U.S. Fidelity & Guaranty Co*.[194] The court held that the liability insurer had no tort liability to its insured where it had not assumed defense of the claim.[195] Yet, the court noted that where a liability insurer does assume responsibility for defense of the claim, it has both a fiduciary duty and a duty of good faith.[196] Only then may the insurer be sued in tort for a violation of either duty.[197] Therefore, assumption of the defense to a third-party claim asserted against its insured is a predicate to a tort-based bad faith action against the insurer by a first-party claimant. Consequently, Oregon offers only limited and narrow avenues of recovery even for first-party claimants. Due to these limitations on tort actions, Oregon is deemed a "Straw" state.

Pennsylvania

In *Terletsky v. Prudential Property & Casualty Insurance Co.*, the Pennsylvania Superior Court explained that the term "bad faith" includes "any frivolous or unfounded refusal to pay proceeds of a policy."[198] Pennsylvania law allows a first-party claimant to bring an action in contract; however, it rejects the first-party claimant's ability to bring the claim in tort.[199] As a result, there is no traditional common law remedy for bad faith handling of insurance claims under the state's law.[200] Nevertheless, in addition to the contract claim, the Pennsylvania legislature provided a statutory remedy. In an action arising under an insurance policy where the court finds that the insurer has acted in bad faith toward the insured, the court may "[a]ward interest on the amount of the

193. OR. REV. STAT. § 746.230 (2009); Emp'rs Fire Ins. Co. v. Love It Ice Cream Co., 670 P.2d 160, 164 (Or. Ct. App. 1983).

194. *Farris*, 542 P.2d 1015.

195. *See id.* at 1018–19.

196. *See id.*

197. *See id.*

198. Terletsky v. Prudential Prop. & Cas. Ins. Co., 649 A.2d 680, 688 (Pa. Super. Ct. 1994) (quoting BLACK'S LAW DICTIONARY 139 (6th ed. 1990)).

199. *See* D'Ambrosio v. Pa. Nat'l Mut. Cas. Ins. Co., 431 A.2d 966, 970 (Pa. 1981).

200. *See id.* at 970–72.

claim," "[a]ward of punitive damages against the insurer," and "[a]ssess court costs and attorney fees against the insurer."[201] Most recently, in *Pavlick v. Encompass Indemnity Insurance Co.*, the United States District Court for the Western District of Pennsylvania restated that Pennsylvania law recognizes a "common law action for bad faith sounding in contract," and recognized that the statute alone "authorizes additional damages when the insurer acts in bad faith."[202] Thus, the statute "supplements the breach of contract damages an injured insured can obtain."[203] The statute was later held to be preempted by ERISA,[204] but it is unclear to what extent the preemption is limited. Given these degrees of protection, Pennsylvania is a "Straw" state.

Tennessee

In Tennessee, state law provides a statutory penalty for bad faith that allows an insured to recover actual damages if the insured suffers a loss and the insurer refuses to pay the claim within sixty days after a demand is made, linking recovery to a percentage of the loss suffered.[205] However, case law provides that Tennessee does not recognize a bad faith tort between an insured and an insurer.[206] Specifically, Tennessee law provides:

> Nowhere in [previous case law] does our Supreme Court state that it is acknowledging the tort of bad

---

201. 42 PA. CONS. STAT. ANN. § 8371 (West 2007), *preempted by* ERISA, Barber v. Unum Life Ins. Co. of Am., 383 F.3d 134 (3d Cir. 2004).

202. Pavlick v. Encompass Indem. Ins. Co., No. 11cv705, 2011 WL 2784584, at *5 (W.D. Pa. July 14, 2011) (citing Simmons v. Nationwide Mut. Fire Ins. Co., 788 F. Supp. 2d 404 (W.D. Pa. 2011)) (quoting Johnson v. Beane, 664 A.2d 96, 101 (Pa. 1995) (Cappy, J., concurring)) (internal quotations omitted).

203. *Id.*

204. Barber v. Unum Life Ins. Co. of Am., 383 F.3d 134, 141–42 (3d Cir. 2004). The statute is pre-empted by ERISA when the plaintiff brings an action for bad faith brought by an employee under an insurance plan provided by an employer. However, the statute still applies in actions for bad faith outside of ERISA plans.

205. TENN. CODE ANN. § 56-7-105 (2008).

206. *See* Givens v. Tenn. Football, Inc., 684 F. Supp. 2d 985, 991 (M.D. Tenn. 2010); Chandler v. Prudential Ins. Co., 715 S.W.2d 615, 621 (Tenn. Ct. App. 1986).

> faith in this state. . . . Certainly, acts of fraudulent inducement amount to "bad faith," but where contractual relief is given on those grounds, this cannot be construed as recognizing the existence of the tort of bad faith in this state.[207]

Recently, in *Givens v. Tennessee Football, Inc.*, the United States District Court for the Middle District of Tennessee reiterated that there is no independent tort for exercising bad faith in the performance of a contract under Tennessee state law.[208] More specifically, the court held although there is an implied duty of good faith and fair dealing in all contracts, "[t]he duty does not apply . . . to the formation of the contract, and does not extend beyond the agreed upon terms of the contract and the reasonable contractual expectations of the parties."[209] Further, the Tennessee statute "is not . . . a punitive penalty for bad faith," but is instead "authority for recovery of additional damages caused by a breach of an insurance contract above and beyond the obvious recovery."[210] Therefore, based on Tennessee's failure to recognize the tort of bad faith and the limitation on damages, it is considered a "Straw" state.

Utah

Utah is deemed a "Straw" state based on decisions such as *Sperry v. Sperry*.[211] In *Sperry*, the plaintiff brought a bad faith and misrepresentation claim against the insurer in connection with an automobile accident where plaintiff was a passenger, plaintiff's husband was the driver, and plaintiff's son was killed.[212] The complex facts in the case resulted in a decision by the court affirming the dismissal of the plaintiff's bad faith claim because she was deemed a third party for purposes of her wrongful death claim brought on behalf of her son's estate against her co-insured husband.[213] The plaintiff asserted that as a named insured, she was a

---

207. *Chandler*, 715 S.W.2d at 621.

208. *Givens*, 684 F. Supp. 2d at 991.

209. *Id.*

210. Rice v. Van Wagoner Cos., Inc., 738 F. Supp. 252, 254 (M.D. Tenn. 1990); *see* TENN. CODE ANN. § 56-7-105.

211. 990 P.2d 381 (Utah 1999).

212. *Id.* at 382.

213. *Id.* at 384.

first-party claimant and was owed a duty of good faith,[214] but the court disagreed, holding that the plaintiff's wrongful death claim on behalf of her son's estate, which was based on her husband's negligence and not her own coverage, placed her in the position of a third party with respect to the duties of her husband's liability insurance carrier to defend him.[215] Consequently, in applying Utah law, the court held that the duty of good faith is owed to first parties only and that the lower court properly dismissed the plaintiff's claim.[216] Therefore, Utah does recognize a first-party claim for bad faith in contract, as well as provide statutory protections in its enacted statute entitled, "Unfair claim settlement practices."[217] However, the statute and related case law hold that the statute does not create a private right of action.[218] As a result, Utah is deemed a "Straw" state.

Virginia

Similar to many other states that limit claims for unfair insurance practices and which have enacted similarly titled statutory provisions, Virginia limits violations of its statute to only administrative remedies. Moreover, courts maintain that the statute does not establish a private right of action. In *A & E Supply Co. v. Nationwide Mutual Fire Insurance Co.*, where the insured's building was completely destroyed by fire, the insurer refused to pay the claim based on a finding that the fire was intentionally set.[219] The court reversed an award of punitive damages because the plaintiff failed to establish an independent and willful tort.[220] Further, there was no recovery of punitive damages for the insurer's violation of the Virginia Unfair Insurance Practices Act because the statute did not establish a private right of action.[221] Perhaps more importantly, the court refused to recognize a remedy in tort for a bad faith re-

214. *Id.* at 383.
215. *Id.* at 384.
216. *Id.*
217. UTAH CODE ANN. § 31A-26-303 (LexisNexis 2010).
218. *Id.*; *see* Cannon v. Travelers Indem. Co., 994 P.2d 824, 828 (Utah Ct. App. 2000).
219. A & E Supply Co. v. Nationwide Mut. Fire Ins. Co., 798 F.2d 669, 670 (4th Cir. 1986).
220. *Id.* at 676–78.
221. *Id.* at 673.

fusal to honor a first-party insurance claim.[222] Therefore, under Virginia law, there is no recognition of a tort for bad faith. However, Virginia does permit an action in contract. For those reasons, as with most states that limit avenues for recovery, Virginia is a "Straw" state.

It is clear from a review of bad faith in states that are considered "Straw Houses," that these states provide only limited protections for insureds. States in this category offer the narrowest avenues for claims—even for first-party claimants—including limited rights of recovery, little or no recognition of a tort for bad faith, and limited recovery through statutory provisions for insureds against insurers for failures in the handling of claims. Further, these states have a common feature of providing no private right of action under any unfair claims practices statute. This sends an unequivocal message that when states offer limited protections to injured claimants for bad faith claims, their protections are similar to houses of straw which can be blown down easily with a huff and a puff.

B. Houses of Stick

"Stick House" states offer slightly more protection than "Straw House" states and adopt a broader definition and application of bad faith for claims. In particular, a number of these states provide an action in tort for bad faith rather than limiting a plaintiff's claims to contract actions only. However, these states provide few, if any, protections for third-party claimants. The majority of states fall into this category in the analogy. They include: Alaska, Arizona, Arkansas, Colorado, Connecticut, Delaware, Hawaii, Illinois, Idaho, Indiana, Massachusetts, Minnesota, Mississippi, Nebraska, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Texas, Vermont, Wisconsin, and Wyoming. Again, a state-by-state analysis is instructive as to the added protections these states have compared to "Straw" states, and is also helpful in examining common elements in defining and applying bad faith.

Alaska

222. *Id.* at 676–77.

Bad faith litigation in Alaska is framed by the decision in *O.K. Lumber Co. v. Providence Washington Insurance Co.*[223] When the insurer failed to promptly settle the claim, the appellant asserted theories for breach of the duty of good faith and fair dealing and alleged violation of Alaska's Unfair Claims Settlement Practices Act and the Unfair Trade Practices and Consumer Protection Act.[224] The Supreme Court of Alaska concluded that the injured third-party claimant could not sue an insurer for breach of the duty of good faith and fair dealing.[225] Further, the court ruled that a third-party claimant had no cause of action against an insurer under either statute, thereby limiting available avenues of recovery for aggrieved third parties.[226] Thus, the court expressly limited the rights of action for third-party claimants, while recognizing a tort claim for first-party insureds. Additionally, in *State Farm Fire & Casualty Co. v. Nicholson*, the court held that punitive damages could be recovered if the insurer acted with malice, bad motives, or reckless indifference to the interests of the insured.[227] Consequently, it is clear that Alaska offers some, albeit not the most, protection for claimants.

Arizona

Bad faith claims are recognized in Arizona, but the state courts' statutory interpretation and case law have narrowed claimants' rights. In *Melancon v. USAA Casualty Insurance Co.*, the insureds brought an action against the insurer for bad faith.[228] The trial court jury returned a verdict for the insureds and awarded damages for breach of contract, breach of the duty of good faith and fair dealing, and punitive damages.[229] The insurer sought review, and the Arizona Court of Appeals affirmed the jury's verdict for damages based on breach of contract. However, the court

223. O.K. Lumber Co. v. Providence Wash. Ins. Co., 759 P.2d 523 (Alaska 1988).

224. *Id.* at 524.

225. *Id.* at 525–26.

226. *Id.* at 527–28.

227. State Farm Fire & Cas. Co. v. Nicholson, 777 P.2d. 1152, 1158 (Alaska 1989).

228. *See* Melancon v. USAA Cas. Ins. Co., 849 P.2d 1374 (Ariz. Ct. App. 1992).

229. *Id.* at 1375.

found error in a jury instruction whose language was taken directly from the Unfair Claim Settlement Practices Act, which directly prohibits a private right of action for a violation of the Act.[230] The court then reversed the award of consequential and punitive damages.[231] Significant to the "house" analogy, the court held that the Act did not give rise to civil liability in tort, and stated that the statute "was enacted solely to provide the Arizona Department of Insurance an administrative method to safeguard the public, not to provide a cause of action for any individual."[232]

However, in *Noble v. National American Life Insurance Co*., the Arizona Supreme Court held there is an implied duty in all insurance contracts that the insurer must act in good faith when handling the claims of its insured.[233] The court stated that violation of the duty would be the basis for an independent tort cause of action.[234] Review of bad faith in Arizona is representative of a distinct category for "Stick" states: those that recognize an independent tort and have statutes which address unfair and improper claims practices, but by direct provision of the statute or through jurisprudence, have determined that the statute does not bestow a private right of action for those individuals directly harmed by the exact practices deemed unfair and improper. For this reason, states that adopt similar provisions but provide for no private right of action within their statutory schemes fall into the category of "Stick" states.

Arkansas

In Arkansas, a claimant may bring a claim for bad faith as a tort claim, a violation of the Arkansas Deceptive Trade Practices Act,[235] and a breach of insurance contract claim. In *Williams v.*

---

230. *Id.* at 1376–77.

231. *Id.* at 1378.

232. *Id.*

233. Noble v. Nat'l Am. Life Ins. Co., 624 P.2d 866, 868 (Ariz. 1981) (en banc).

234. *Id.*

235. ARK. CODE ANN. §§ 4-88-101 to -115 (2001 & Supp. 2011) (regulating deceptive trade practices generally); ARK. CODE ANN. §§ 23-66-201 to -215 (2001 & Supp. 2011) (regulating trade practices in the insurance industry); *but see* ARK. CODE ANN. § 23-66-202(b) (stating that "no provisions of this sub-

State Farm Mutual Automobile Insurance Co., the insureds' claims arose out of a dispute over reimbursements to the insurer from the insureds' tort recoveries.[236] While the plaintiffs' complaint was dismissed for failure to meet pleading standards, the case provides an historical account of the development of bad faith claims under Arkansas law.[237] Here, the state requires that in order for a claimant to prevail on a bad faith claim, the trier of fact must find that the insurer's actions, when attempting to avoid its liability under the insurance policy, were "dishonest, malicious, or oppressive."[238] Arkansas's bad faith law simply requires that an insurer abide by the provisions of the insurance contract in good faith and allows for remedies, including punitive damages, if the insurer does not do so.[239] However, an insurer's refusal to pay a claim where a good faith dispute exists as to amount due is not considered bad faith.[240]

Also, the Arkansas law provides for recovery of extra-contractual damages by the insured if the insurer fails to pay the claim within the time specified in the policy.[241] Under this statute, in addition to the amount of the claim, the insured may recover a percentage of the loss plus attorneys' fees.[242] Furthermore, while punitive damages may be available, these damages may only be awarded based on conduct that is "malicious, wanton, in violation of a relationship of trust or confidence, or which is done with a deliberate intent to injure another."[243] Lastly, a third-party tort claimant has no right to assert bad faith claims against the tortfeasor's liability insurer.[244] Hence, Arkansas qualifies as a "Stick"

---

chapter are intended to establish or extinguish a private right of action for a violation of any provision of this subchapter").

236. Williams v. State Farm Mut. Auto. Ins. Co., No. 5:10CV00032 JLH, 2010 U.S. Dist. LEXIS 61613 (E.D. Ark. Jun. 22, 2010).

237. *Id.* at *16–17.

238. *Id.* at *6–8 (quoting Aetna Cas. & Sur. Co. v. Broadway Arms Corp., 664 S.W.2d 463, 465 (Ark. 1984)) (internal quotation marks omitted).

239. *See* Columbia Nat'l Ins. Co. v. Freeman, 64 S.W.3d 720, 723 (Ark. 2002); Emp'rs Equitable Life Ins. Co. v. Williams, 665 S.W.2d 873, 874 (Ark. 1984).

240. Stevenson v. Union Standard Ins. Co., 746 S.W.2d 39, 42 (Ark. 1988).

241. ARK. CODE ANN. § 23-79-208 (2004 & Supp. 2011).

242. *Id.*

243. Ray Dodge, Inc. v. Moore, 479 S.W.2d 518, 523 (Ark. 1972).

244. *See* Bell v. Kansas City Fire & Marine Ins. Co., 616 F. Supp. 1305, 1308 (W.D. Ark. 1985) (holding that although Oklahoma law was controlling in

state in that it provides avenues of recovery, but similar to other states in this category, provides no protections for third-party claimants.

Colorado

Colorado recognizes a cause of action in tort for an insurer's bad faith breach of its obligations under its contract with its insured.[245] The basis for such tort liability is "grounded upon the special nature of the insurance contract and the relationship which exists between the insurer and the insured."[246] In addition to recognizing the tort directly, Colorado also has statutory causes of action for bad faith, but it does not allow a private cause of action under its unfair claim settlement practices statutes or unfair competition statute.[247] Specifically, Colorado courts have held that violation of the Unfair Claims Practices Act "may not serve as the sole basis for a civil action instituted by private citizens allegedly aggrieved by the conduct of their insurers."[248]

Similar to Arizona, the Colorado Court of Appeals found that no private right of action exists under the statute defining unfair or improper claims practices. In *Farmers Group, Inc. v. Trimble*—where a father and son were insureds under two policies, and where the son drove his father's car onto the neighboring home's yard, seriously injuring its resident—the court found that the Unfair Claims Practices Act did not create a private right of action.[249] In that case, the insurer's adjuster selected an attorney to defend its

---

the case, "the court remain[ed] unconvinced that plaintiffs' claims would be recognized in the state of Arkansas").

245. Goodson v. Am. Standard Ins. Co., 89 P.3d 409, 414 (Colo. 2004) (citing Cary v. United of Omaha Life Ins. Co., 68 P.3d 462, 466 (Colo. 2003)); Vaughan v. McMinn, 945 P.2d 404, 406 (Colo. 1997); Farmers Grp., Inc. v. Trimble, 691 P.2d 1138, 1141 (Colo. 1984).

246. *Trimble*, 691 P.2d at 1141; *see Goodson*, 89 P.3d at 414–15.

247. COLO. REV. STAT. § 10-3-1113 (2011).

248. Farmers Group, Inc. v. Trimble, 658 P.2d 1370, 1378 (Colo. App. 1982), *aff'd*, 691 P.2d 1138 (Colo. 1984); *see, e.g.*, Simmons v. Prudential Ins. Co., 641 F. Supp. 675, 684 (D. Colo. 1986) (recognizing no right of action, despite the Colorado Supreme Court not having yet answered the question); Appel v. Sentry Life Ins. Co., 701 P.2d 634, 637 (Colo. App. 1985) (applying *Trimble*), *aff'd*, 739 P.2d 1380 (Colo. 1987).

249. *Trimble* at 1372–73, 1378.

insureds and, at the same time, filed suit seeking a declaration of the policies' coverage.[250] The insureds then filed counterclaims seeking damages caused by the insurer's misconduct and bad faith in handling the claims.[251] The underlying case settled and the court dismissed the insurer's declaratory judgment action. However, the court ultimately held that the insureds' counterclaims were proper and remanded those claims for further proceedings.[252] The court's holding illustrates how an insurer's decision to seek a declaratory judgment requesting a determination as to coverage, while simultaneously defending the action, may result in an increase in bad faith claims. This is because insureds are required to answer the declaratory judgment action and make compulsory counterclaims for bad faith for the delay caused by the filing of the declaratory judgment proceedings, resulting in an increase in bad faith claims, contributing to the rise in bad faith actions generally.

In further defining bad faith in Colorado, cases in the first-party insurance bad faith context are instructive. Here, "[t]he insurer's actions expose the insured to being personally liable for the monetary obligations underlying the insured's claims."[253] In *Travelers Insurance Co. v. Savio*, the Colorado Supreme Court held that unreasonable conduct by an insurer is determined on an objective basis and will require proof of the standard of conduct in the industry.[254]

Following this decision, the Colorado Court of Appeals determined that an insurer's deviation from the standards of the industry contributed to a judgment for the insured on his bad faith claim in *Brewer v. American and Foreign Insurance Co.*[255] Here, the insurer argued that there could be no bad faith claim if there was "any colorable evidence supporting the denial of an insurance claim."[256] The court disagreed, holding that although the insured's case could not, as a matter of law, be decided by directed verdict on the underlying claim, the bad faith issue could still be decided

---

250. *Id.* at 1373.
251. *Id.* at 1378.
252. *Id.*
253. Goodson v. Am. Standard Ins. Co., 89 P.3d 409, 414 (Colo. 2004).
254. Travelers Ins. Co. v. Savio, 706 P.2d 1258, 1275 (Colo. 1985).
255. Brewer v. Am. & Foreign Ins. Co., 837 P.2d 236, 238 (Colo. App. 1992).
256. *Id.*

in favor of the insured.[257] In other words, the court determined that the insurer's actions in the handling of the claim may be adequate to support a bad faith claim, even without a determination on the underlying claim at the summary judgment or directed verdict stage.

In terms of available remedies in Colorado, where an insurer has breached its obligation to act in good faith, "[c]ompensatory damages for economic and non-economic losses are available to make the insured whole and, where appropriate, punitive damages are available to punish the insurer and deter wrongful conduct by other insurers."[258] As the Colorado Supreme Court held in *Goodson v. American Standard Insurance Co.*, individuals can recover damages for emotional distress for unreasonable delays by their insurance company in providing benefits under a policy even if the insurance company ultimately pays all benefits owed.[259] In *Goodson*, the plaintiff brought several causes of action and the court noted that

> insureds can plead multiple alternative claims against insurers, including but not limited to the following: a contract action for ordinary and/or willful breach of the insurance contract; a tort action for bad faith breach of the insurance contract; outrageous conduct; fraud, misrepresentation, or deceit; civil conspiracy. . . .[260]

Also, Colorado provides for assignment to third-party claimants, but does not permit a direct action by a third-party claimant against an insurer.[261] In *Northland Insurance Co. v. Bashor*, a victim of an automobile accident sued the driver and obtained a judgment in excess of the limit of the driver's automobile insurance policy.[262] The driver assigned his bad faith claim to

---

257. *Id.*

258. *Goodson*, 89 P.3d at 415.

259. *Id.* at 417; *see also* Burgess v. Mid-Century Ins. Co., 841 P.2d 325 (Colo. App. 1992).

260. *Goodson*, 89 P.3d at 413 n.2.

261. Schnaker v. State Farm Mut. Auto. Ins. Co., 843 P.2d. 102, 104–05 (Colo. App. 1992).

262. Northland Ins. Co. v. Bashor, 494 P.2d 1292, 1293 (Colo. 1972).

the accident victim in exchange for a small sum and an agreement not to collect on the judgment.[263] The Colorado Supreme Court held that the assignment was valid and that the victim had not been fully compensated.[264] Therefore, due to Colorado's recognition of the tort of bad faith, as well as a breach of contract claim and the availability of an assignment to the third-party petitioner for the tort of bad faith, Colorado is considered a "Stick" state.

Connecticut

Connecticut has recognized an "independent cause of action in tort arising from an insurer's common law duty of good faith."[265] However, a third-party tort claimant has no right to assert bad faith claims directly against the tortfeasor's liability insurer.[266] In a scheme similar to other "Stick" states, Connecticut limits the ability of the third-party claimant to bring a direct action against the insurer by statute. In *Sherrick v. Belanger*, the Connecticut Superior Court held that the "statutes and regulations relating to fair settlement practices [cannot] be construed to transform an insurance company's duty to fairly investigate, adjust and settle claims for its own policyholders into a potential statutory tort available to an adversary of its policyholders."[267] In the case, there was neither subrogation nor judicial determination of liability, thus the insurer had no duty to pay the plaintiff anything until the conclusion of the lawsuit against the insureds.[268] Similar to many other states, the Connecticut court required, as a condition precedent, a judicial determination of liability before the third party could proceed in an action against the insurer for bad faith. Consequently, because of its limitation for third-party claimants to bring direct

263. *Id.*

264. *Id.*

265. Buckman v. People Express, Inc., 530 A.2d 596, 599 (Conn. 1987); *see also* McCauley Enters. v. N.H. Ins. Co., 716 F. Supp. 718, 721 (D. Conn. 1989) (citing *Buckman*, 530 A.2d at 599).

266. *See* Scribner v. AIU Ins. Co., 647 A.2d 48, 51 (Conn. Super. Ct. 1994).

267. Sherrick v. Belanger, No. HHBCV065000584, 2007 Conn. Super. LEXIS 2171, *3–4 (Conn. Super. Ct. Aug. 7, 2007).

268. *Id.* at *4.

actions against the insurer for the insurer's treatment and handling of the claim, Connecticut is deemed a "Stick" state.

Delaware

In Delaware, in a complicated case which involved ERISA preemption claims, the Delaware Superior Court held that a common law breach of contract, a wrongful death claim, and a claim for misrepresentation could not be brought under the Delaware statute for unfair insurance practices[269] as it was preempted by ERISA and barred by Delaware case law.[270] However, similar to other "Stick" states, Delaware does recognize a bad faith action in tort as well as a right for the claimant to bring the claim in contract, but does not provide any remedy for the third party to bring a direct action against the insurer. Specifically, in *Playtex FP, Inc. v. Columbia Casualty Co.*, the court held that "a private party may not pursue a private cause of action against an insurance company under the [Delaware Unfair Trade Practices Act]."[271]

Hawaii

In Hawaii, *Best Place v. Penn American Insurance Co.* held that "there is a legal duty, implied in a first- and third-party insurance contract that the insurer must act in good faith in dealing with its insured, and a breach of that duty of good faith gives rise to an independent tort cause of action."[272] However, an action for breach of the implied covenant of good faith and fair dealing does not require a breach of the express covenant to pay claims.[273] "The implied covenant is breached, whether the carrier pays the claim or not, when its conduct damages the very protection or security which the insured sought to gain by buying insurance."[274]

---

269. DEL. CODE ANN. tit. 18, § 2304 (1999 & Supp. 2010).

270. Yardley v. U.S. Healthcare, Inc., 698 A.2d 979, 988 (Del. Super. Ct. 1996), *aff'd,* 693 A.2d 1083 (Del. 1997).

271. Playtex FP, Inc. v. Columbia Cas. Co., No. C. A. 88C-MR-233, 1993 Del. Super. LEXIS 58, *8. (Del. Super. Ct. Feb. 19, 1993).

272. Best Place v. Penn Am. Ins. Co., 920 P.2d 334, 346 (Haw. 1996).

273. *Id.* (citing Rawlings v. Apodaca, 726 P.2d 565, 573 (Ariz. 1986)).

274. *Id*. (quoting *Rawlings*, 726 P.2d at 573) (internal quotation marks omitted).

Following, in *Simmons v. Puu*, a third-party claimant filed suit against a driver and rental car agency, where the agency was the self-insurer of the automobile, for bad faith settlement practices.[275] The Hawaii Supreme Court held that the common law tort of bad faith arose out of an insurer's contractual duty to deal in good faith and an injured third-party claimant did not have a claim for relief unless the insured tortfeasor assigned the claim to him.[276] The court limited bad faith claims under Hawaii state law to first-party claims or those of first-party claimants assigned to another individual. Specifically, in *Simmons,* the court held that a contractual relationship was needed for the third party to proceed.[277] Therefore, Hawaii does permit a direct action for a third party *after* assignment of the claim from the insured. Because Hawaii recognizes an action in tort for bad faith as well as an action in contract, in addition to some protections for the third-party claimant, albeit after assignment, Hawaii qualifies as a "Stick" state.

Idaho

The Supreme Court of Idaho has addressed the parameters of a first-party claim where the insured sued for breach of contract and the tort of first-party bad faith. In the case of *Robinson v. State Farm Mutual Insurance Co.*, the insured sued for bad faith and received a verdict for compensatory damages and $9.5 million in punitive damages[278]

The Supreme Court of Idaho held that to establish a case for bad faith, a plaintiff must

> establish (1) that coverage of [the] claim was not fairly debatable; (2) . . . that based on the evidence the insurer had before it, the insurer intentionally and unreasonably withheld her benefits; (3) that the delay in payment was not the result of a good faith

275. Simmons v. Puu, 94 P.3d 667 (Haw. 2004).
276. *Id.* at 677–78.
277. *Id.* at 684.
278. Robinson v. State Farm Mut. Auto. Ins. Co., 45 P.3d 829, 832 (Idaho 2002).

> mistake; and (4) that the resulting harm was not fully compensable by contract damages.[279]

Despite these protections, Idaho law does not provide a direct action for third-party claimants for bad faith. Thus, Idaho is relegated to the "Stick" category as a state that provides some protections, but does not go as far as those states deemed "Brick" states, which provide broader protections, including protections for third-parties.

Indiana

Indiana is considered a "Stick" state based on the Indiana Court of Appeals decision in cases such as *Allstate Insurance Co. v. Fields*.[280] In this case, the insured was in an auto accident and sued the other driver, whose insurer later went into liquidation.[281] The insured then requested Uninsured Motorist ("UM") coverage under his policy, submitted his medical bills, and demanded the policy limits.[282] The insurer stated that it would not offer a settlement until the insured provided additional information, including a proof of loss form and estimates of the repairs to the vehicle.[283] In response, the insured filed an action for bad faith on the delay and violation of Indiana's Unfair Claims Settlement Practices Act.[284] At trial, the insured was awarded compensatory and punitive damages.[285] The appellate court reversed and entered summary judgment in favor of the insurer, holding that the settlement of the insured's claim was delayed, in part, by the insured's refusal to submit the insurer's proof of loss form.[286] Based on the facts, the appellate court ruled that there was no indication of bad faith by the

---

279. *Id.* at 834. The case was ultimately remanded because the district court improperly assigned the burden of proving the claim was fairly debatable on the insurer rather than the insured, and because the district court improperly determined that proof of coverage was not an element of a bad faith claim. *Id.* at 833–36.

280. 885 N.E.2d 728 (Ind. Ct. App. 2008).

281. *Id.* at 729.

282. *Id.* at 729–30.

283. *Id.* at 730.

284. *Id.* at 731.

285. *Id.*

286. *Id.* at 733–34.

insurer between the time the insured made a UM claim under the policy and the time the insured filed a bad faith claim against the insurer.[287]

Indiana recognizes the tort of bad faith and also permits actions in contract.[288] As a result, Indiana falls into the category of a "Stick" state. However, an interesting wrinkle arises in Indiana law that allows the insurer to require additional information even after a claimant has properly filed his claim against the original tortfeasor and his insurer.[289] As such, Indiana permits insurers the opportunity to delay payments to first-party insureds based on requests for additional information.[290] Certainly, the insurer should have the ability to obtain the necessary information in order to make a reasonable coverage decision; however, here the insured had already properly made his claim and was proceeding against the tortfeasor's insurer when that insurer filed for liquidation.[291] Indiana granted wide latitude to the insurer in the handling of its own insured's claim by allowing the insurer to require the insured to begin the claim anew and basing this notion on a broad interpretation of "promptly settling a claim" in the case.[292] As a result, Indiana qualifies as a "Stick" state because it provides moderate protections to a claimant.

Massachusetts

In contrast to Indiana, in *Tallent v. Liberty Mutual Insurance Co.*, the Superior Court of Massachusetts was explicit in its rebuke of the practices of the insurer in a delay of payment of a claim case.[293] While not identical to *Fields*, issues in *Tallent* regarding delay of payment and the particular conduct of the insurer raised similar concerns. In *Tallent*, the plaintiffs brought a claim against the defendant insurer under a Massachusetts statute which

287. *Id.*

288. Erie Ins. Co. v. Hickman, 622 N.E.2d 515, 519 (Ind. 1993).

289. *See Fields*, 885 N.E.2d at 733–34.

290. *Id.* (noting that the insurer's request for additional information was permissible because it was not made in bad faith).

291. *Id.* at 729–30.

292. *See id.* at 733–34.

293. Tallent v. Liberty Mut. Ins. Co., No. 1997-1777H, 2005 Mass. Super. LEXIS 260, at *50–58 (Mass. Super. Ct. Apr. 25, 2005).

provides a private right of action.[294] The plaintiffs further alleged violations of statutory provisions where the insurance company refused to settle without conducting a reasonable investigation, and failed to settle despite the fact that underlying liability seemed reasonably clear.[295] Despite advice of employees and seasoned counsel, the insurer insisted upon filing an appeal rather than attempting to settle with the plaintiff and his wife.[296] After the appeal was summarily decided against the insurer, the insurer tried unsuccessfully to have the case reviewed. In the end, the insurer was exposed to double damages for the delay in paying the judgment for its unreasonable conduct, which amounted to bad faith, although the bad faith was not egregious enough to support an award of treble damages.[297] As a result, under Massachusetts law, even a delay in paying a claim may suffice for a claim of bad faith against the insurer.

In addition to the above, Massachusetts is a state which provides insured first-party claimants statutory avenues by which they may proceed for bad faith claims. Pursuant to *McEvoy Travel Bureau, Inc. v. Norton Co.*, the multiple damages provision of the state statute[298] is punitive in nature.[299] Therefore, Massachusetts offers broad protections for insureds; however, it does not constitute a "Brick" state simply because of its lack of redress for third-party claimants and thus is categorized as a "Stick" state.

Minnesota

Minnesota is also considered a "Stick" state. This designation is based on several factors. Minnesota permits the first-party

---

294. *Id.* at *24–25. The plaintiffs sued under Chapter 93A of the Massachusetts General Laws. *Id.* at *1; *see* MASS. GEN. LAWS ch. 93A, §§ 1–11 (West 2006). Section 2 of Chapter 93A has been found to be preempted by the Fair Credit Reporting Act, 15 U.S.C. § 1681s-2 (2006). *See* Catanzaro v. Experian Info. Solutions, Inc., 671 F. Supp. 2d 256 (D. Mass. 2009).

295. *Id.* at *1. Years earlier, the plaintiffs obtained a judgment against the underlying general contractor for the injuries sustained by the worker. *Id.* at *1–6.

296. *See id.* at *11–18.

297. *Id.* at *58–59.

298. MASS. GEN. LAWS ANN. ch. 93A, §§ 1–11.

299. McEvoy Travel Bureau, Inc. v. Norton Co., 563 N.E.2d 188, 196 (Mass. 1990).

claimant to bring a tort action for bad faith as well as one in contract. In *266 Summit, LLC v. Lawyers Title Insurance Corp.*, the insureds asserted several causes of action arising out of a contract of title insurance on real property.[300] The insureds alleged claims of bad faith and punitive damages. The United States District Court for the District of Minnesota, applying state law, granted the insurer's motion for summary judgment and held the insurer had no duty to defend the insureds under the policy; therefore, the bad faith action could not stand.[301] Further, the insurer did not allege separate tortious conduct and simply re-characterized its breach of contract claim as a bad faith claim, and thus it also failed.[302]

While Minnesota recognizes causes of action for an insurer's bad faith in first-party cases, it does not recognize first-party bad faith tort claims where the insured, covered by a policy providing benefits directly with the insurer (such as health or medical insurance or disability coverage), has a right to seek extra-contractual damages for their insurer's breach of contract.[303] However, in 2008, the Minnesota Legislature created a private cause of action for bad faith in first-party insurance claims other than those where the insured has health, medical, or disability insurance coverage.[304] The statute limits recovery to "taxable costs" as a penalty if the insured can show:

> (1) the absence of a reasonable basis for denying the benefits of the insurance policy; and (2) that the insurer knew of the lack of a reasonable basis for denying the benefits of the insurance policy or acted in reckless disregard of the lack of a reasonable basis for denying the benefits of the insurance policy.[305]

---

300. 266 Summit, LLC v. Lawyers Title Ins. Corp., No. 10-4051, 2011 WL 3020301, at *1 (D. Minn. July 22, 2011).

301. *Id.* at *7.

302. *Id.* at *8.

303. *See* Haagenson v. Nat'l Farmers Union Prop. & Cas. Co., 277 N.W.2d 648 (Minn. 1979); Pillsbury Co. v. Nat'l Union Fire Ins. Co., 425 N.W.2d 244 (Minn. Ct. App. 1988).

304. MINN. STAT. ANN. § 604.18 (West 2010).

305. *Id.* § 604.18(2)(a).

Policyholders can be awarded up to $250,000 in taxable costs and up to $100,000 in attorneys' fees if both elements are satisfied.[306]

Addressing the statute, the district court stated in *Friedberg v. Chubb and Son, Inc.*, that the Minnesota statute was similar to other states' provisions, which rely on a two-part test.[307] The first prong asks whether a reasonable insurer, under similar facts and circumstances, would have denied or delayed paying the claim, and includes the question of whether the claim was investigated correctly and whether the investigation was reasonably evaluated.[308] The first prong is an objective standard, while the second prong encompasses a subjective standard. Under the second prong, the question is whether the "insurer knew of the lack of a reasonable basis for denying the benefits of the insurance policy" and when they knew it.[309] However, the *Friedberg* court also stated that "when a claim is fairly debatable, the insurer is entitled to debate it, whether the debate concerns a matter of fact or law."[310] Similar to other states, if the insurer's denial or delay was reasonable, even if erroneous, the first prong has not been met and there is no need to address the second prong.

Despite these protections, Minnesota is considered a "Stick" state based on the insurer's ability to include an anti-assignment provision in the contract,[311] which precludes insureds from the ability to assign their rights to third parties despite permitting bad faith claims in contract and tort. When the insurer does not include such an express provision in the contract, Minnesota recognizes the value of an assignment of a first-party action to an injured third-party. In *Lange v. Fidelity & Casualty Co. of New York*, the Minnesota Supreme Court recognized the validity of an

---

306. *Id.* § 604.18(3)(a).

307. Friedberg v. Chubb and Son, Inc., 800 F. Supp. 2d 1020, 1025 (D. Minn. 2011).

308. *Id.* at 1025.

309. *Id.*

310. *Id.*

311. Star Windshield Repair, Inc. v. W. Nat'l Ins. Co., 768 N.W.2d 346, 350 (Minn. 2009) ("[T]he anti-assignment clauses in the auto insurance policies do not preclude a policyholder's assignment of post-loss proceeds to an auto glass vendor."). This case is limited to the assignment of post-loss proceeds; the court refused to address whether "whether anti-assignment clauses in insurance policies are, as a rule, enforceable." *Id.*

insured assigning his cause of action, ruling that on an involuntary assignment to a receiver:

> The vast majority of states permit an insured to assign his cause of action against the carrier to the injured claimant, even if there is no express statutory authority permitting such assignment. If, as we believe and defendant concedes, a voluntary assignment is permissible, it would be wholly inconsistent to hold that, upon the insured's refusal, assignment could not be made involuntarily where authorized by statutes governing proceedings supplementary to the execution of a judgment.[312]

Therefore, Minnesota does have limits on recognition of first-party claims, damages by statutory provision, and on assignability of claims, thereby qualifying Minnesota as a "Stick" state.

Mississippi

In Mississippi, in *WMS Industries v. Federal Insurance Co.*, the issues were whether the conduct of the defendant insurer constituted a breach of the business contract, and if so, whether the insurer acted in bad faith.[313] The federal district court in *WMS* addressed bad faith under Mississippi law. The court held that a "bad faith refusal claim is an 'independent tort' separable in both law and fact from the contract claim."[314] Further, the court explained that in order for the plaintiff to prove its claim for punitive damages due to bad faith, it must show that the insurer "lacked an arguable or legitimate basis for denying the claim," and that the denial was "willful or malicious" or that the insurer acted with "gross and reckless disregard" of the plaintiff's rights.[315] Conversely, if the insurer could prove in law or fact a reasonable justification for re-

312. Lange v. Fid. & Cas. Co., 185 N.W.2d 881, 886–87 (Minn. 1971) (footnote omitted).

313. WMS Indus. v. Fed. Ins. Co., No. 1:06CV977-LG-JMR, 2009 U.S. Dist. LEXIS 68678, at *1 (S.D. Miss. Aug. 4, 2009).

314. *Id.* at *29 (quoting Hartford Underwriters Ins. Co. v. Williams, 936 So. 2d 888, 895 (Miss. 2006)).

315. *Id.* (citing United Am. Ins. Co. v. Merrill, 978 So. 2d 613, 634 (Miss. 2007)).

fusing payment, it could avoid a bad faith claim, and even if the insurer's denial was incorrect, that alone would be insufficient to prove bad faith.[316] However, the court went on to discuss extra-contractual damages which may still have been available to the plaintiff. The court held that the insurer had a duty to re-evaluate the plaintiff's claim in the case, even after the lawsuit was filed, and that extra-contractual damages, including attorneys' fees, were available when only the first prong of the bad faith test is proven.[317]

Additionally, in *Standard Life Insurance Co. of Indiana v. Veal*, the Supreme Court of Mississippi allowed recovery of punitive damages in a first-party action for bad faith.[318] As a result, Mississippi has recognized a firs party's right to bring a bad faith action in tort, as well as in contract, and to recover punitive damages under such a claim, thereby classifying Mississippi as a "Stick" state.

Nebraska

In Nebraska, in *LeRette v. American Medical Security, Inc.*, insureds filed two causes of action against the insurer.[319] The first cause of action was for breach of an insurance contract, and the second was for bad faith arising out of a health insurance contract.[320] At trial, the jury returned a verdict in favor of the insurer on the contract claim and in favor of the plaintiffs on the bad faith claim.[321] The Nebraska Supreme Court went on to review bad faith, restating that its courts had "recognized a tort of bad faith refusal to 'settle' a claim with an insured policyholder."[322] Also,

316. *Id.*

317. *Id.* at *29–30. Under Mississippi law, "extra-contractual damages include emotional distress, 'attorney fees and legal expenses reasonably and necessarily incurred,' inconvenience, accounting fees, and economic loss." *Id.* at *30 (quoting Pioneer Life Ins. Co. v. Moss, 513 So. 2d 927, 931 (Miss. 1987) (Robertson, J., concurring)).

318. Standard Life Ins. Co. of Ind. v. Veal, 354 So. 2d 239, 248 (Miss. 1977).

319. LeRette v. Am. Med. Sec., Inc., 705 N.W.2d 41, 43 (Neb. 2005).

320. *Id.*

321. *Id.*

322. *Id.* at 47 (citing Braesch v. Union Ins. Co., 464 N.W.2d 769, 772 (Neb. 1991), *disapproved of on other grounds,* Wortman *ex rel.* Wortman v. Unger, 578 N.W.2d 413 (Neb. 1998)).

the court stated that the liability in tort arises from the breach of good faith and fair dealing.[323] For a plaintiff to establish a claim for bad faith under Nebraska law, the "plaintiff must show an absence of a reasonable basis for denying the benefits of the insurance policy and the insurer's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim."[324]

Therefore, in Nebraska, with regard to the standard of care, the tort of bad faith is an intentional one.[325] Additionally, breach of the insurance contract is not a prerequisite to prevail on the bad faith claim because the actions are independent of one another. Ultimately, paying the benefits of the insurance contract does not preclude a viable bad faith claim.[326] However, where the insurer has an "arguable basis" on which to initially deny the claim, there can be no bad faith cause of action as a matter of law, regardless of how an investigation was or was not conducted.[327] Thus, Nebraska law recognizes a tort of bad faith and a breach of contract claim that are independent but can arise out of the same insurance contract.

Another consideration regarding the status of Nebraska in the analogy is its availability and treatment of punitive damages. In *Braesch v. Union Ins. Co.*, the Supreme Court of Nebraska reaffirmed that punitive damages were not allowed in Nebraska.[328] Nonetheless, Nebraska is deemed a "Stick" state based on the tort and contract claims despite the limitation on the availability of punitive damages.

Nevada

---

323. *Id.* (citing Ruwe v. Farmers Mut. United Ins. Co., Inc., 469 N.W.2d 129, 135 (Neb. 1991)).

324. *Id.* at 47–48 (citing Williams v. Allstate Indem. Co., 669 N.W.2d 455, 460 (Neb. 2003); Radecki v. Mut. of Omaha Ins. Co., 583 N.W.2d 320, 325 (Neb. 1998)).

325. *See id.* at 49 ("'Bad faith' by definition cannot be unintentional." (quoting Anderson v. Cont'l Ins. Co., 271 N.W.2d 368, 376 (Wis. 1978))).

326. *Id.* at 48–49.

327. *Id.* at 49–50.

328. Braesch v. Union Ins. Co., 464 N.W.2d 769, 777 (Neb. 1991) (citing Abel v. Conover, 104 N.W.2d 684 (1960)), *disapproved of on other grounds*, Wortman *ex rel.* Wortman v. Unger, 578 N.W.2d 413 (Neb. 1998) (holding that an offer to settle may be made before or after bringing an action).

Similar to many other states in this category, Nevada has an unfair insurance practices statute outlining various practices by insurers that have been deemed to constitute unfair or improper claims practices.[329] In a clarification of the interaction between the statute and a common law bad faith claim, the insured in *Hart v. Prudential Property & Casualty Insurance Co.* alleged common law bad faith in her claim against the insurer when her minor child was injured in a school bus accident.[330] The insured argued that there was no need to prove bad faith because a single violation of the Unfair Claims Practices Act constituted bad faith *per se*.[331] Noting that there was, indeed, a private right of action, the United States District Court for the District of Nevada found that the plaintiff had not pleaded a violation of the Act; rather, she pleaded the common law tort of breach of the implied duty of good faith and fair dealing.[332] Further, the court denied plaintiff's motion for summary judgment, concluding that the Nevada legislature's intent was not to codify the common law tort of bad faith, but to outline other conduct that violated fair practices.[333] Thus the reasonableness of the denial of policy benefits was a question for the jury.[334]

However, in *Crystal Bay General Improvement District v. Aetna Casualty & Surety Co.*, the district court held that a private right of action against the insurer by the insured for unfair claims settlement practices was reasonably implied as the statute is "patently for the benefit of insured persons."[335] More recently, in *Sherwin v. Infinity Auto Insurance Co.*, the district court differentiated between bad faith and unfair claim practices, holding that bad faith requires a denial of the claim.[336] Assertions of unfair claims

---

329. NEV. REV. STAT. ANN. § 686A.310 (LexisNexis 2009).

330. Hart v. Prudential Prop. & Cas. Ins. Co., 848 F. Supp. 900 (D. Nev. 1994).

331. *Id.* at 903–04.

332. *Id.* at 904–05.

333. *See id.*

334. *See id.*

335. Crystal Bay Gen. Improvement Dist. v. Aetna Cas. & Sur. Co., 713 F. Supp. 1371, 1376 (D. Nev. 1989).; *see also* NEV. REV. STAT. ANN. § 686A.310 (LexisNexis 2009).

336. Sherwin v. Infinity Auto Ins. Co., No. 2:11–CV–43 JCM (LRL), 2011 WL 2651876, at *2 (D. Nev. Jul. 6, 2011), *vacated*, 2011 WL 5598344 (D. Nev. Nov. 16, 2011) (vacating the previous grant of summary judgment for Sherwin in order to grant summary judgment on damages in favor of Infinity).

practices address the manner in which an insurer handles a claim, regardless of whether the claim is denied.[337] Therefore, Nevada has differentiated between a common law bad faith claim and a claim under the Unfair Claims Practices Act, providing clarity to the different avenues available to insureds. As a result, Nevada qualifies as a "Stick" state.

New Jersey

In *Pickett v. Lloyd's*, the New Jersey Supreme Court addressed the issue of whether New Jersey recognized a cause of action based upon an alleged bad faith refusal to pay benefits under a first-party insurance claim.[338] The case involved a trucker's claim for property damage to his insured truck resulting from an accident.[339] Despite timely notice of the claim, the insurer mishandled the claim which resulted in extraordinary delays in the payment of the claim and damages to the insured.[340] Interestingly, the court reviewed other states' treatment and recognition of the claim as either one of tort or contract, and observed that "[t]he demands of formalism do not require that we make a tort out of what is really an unfulfilled [contractual] promise."[341] Thus, New Jersey does not recognize a tort for bad faith but does recognize a cause of action for an insurance company's "bad faith" failure to pay an insured's claim.[342]

The court then adopted the "fairly debatable" standard, where an insured must establish: (1) the lack of a reasonable basis for denying coverage benefits, and (2) the insurer's "knowledge or reckless disregard of the lack of a reasonable basis for denying the claim."[343] Implicit in this test is "that the knowledge of the lack of a reasonable basis may be inferred and imputed to an insurance

---

The distinction between bad faith claims and unfair claim practices claims still holds true regardless of the court vacating the previous grant of summary judgment.

337. *Id.* at *2–3.

338. Pickett v. Lloyd's, 621 A.2d 445, 450 (N.J. 1993).

339. *Id.* at 447.

340. *Id.* at 447–49.

341. *Id.* at 452.

342. *Id.* at 457–58.

343. *Id.* at 453 (quoting Anderson v. Cont'l Ins. Co., 271 N.W.2d 368, 376–77 (Wis. 1978)).

company where there is a reckless indifference to facts or to proofs submitted by the insured."[344] In further defining "fairly debatable," the court explained that under this standard, "a claimant who could not have established as a matter of law a right to a summary judgment on the substantive claim would not be entitled to assert a claim for an insurer's bad-faith refusal to pay the claim."[345] The court expressly noted that "[n]either negligence nor mistake is sufficient to show bad faith."[346]

Damages as a result of an insurer's bad faith are measured using contract principles.[347] Thus, the claim is limited to the contract's context. An insurer is liable to an insured for consequential damages in excess of the policy amount if the damages were fairly within the contemplation of the insurer.[348] Also, under New Jersey law, punitive damages are permitted only in egregious circumstances.[349]

More recently, in *Wood v. New Jersey Manufacturers Insurance Co.*, the court restated that it was well-settled state law that every insurance contract contains an implied covenant of good faith and fair dealing.[350] In keeping with the decisions above, New Jersey has recognized a limited cause of action "where there is a settlement demand within the policy limits, the insurer in bad faith refuses to settle the claim, and the verdict above the policy limits is returned."[351] In this situation, an insurer may be liable for the whole judgment, including any excess judgment.[352] The court further addressed this type of claim in *Wood*, concluding that this was a traditional contract claim even when an insurer has failed to set-

---

344. *Anderson*, 271 N.W.2d at 377.

345. *Pickett's*, 621 A.2d at 454.

346. *Id.* (quoting Blue Cross & Blue Shield v. Granger, 461 So. 2d 1320, 1328 (Ala. 1984)) (internal quotation marks omitted).

347. *Id.*

348. *See* Cromartie v. Carteret Sav. & Loan, 649 A.2d 76, 83–84 (N.J. Super. Ct. App. Div. 1994).

349. *Pickett*, 621 A.2d at 455.

350. Wood v. New Jersey Mfrs. Ins. Co., 21 A.3d 1131, 1140 (N.J. 2011) (citing Kalogeras v. 239 Broad Ave., L.L.C., 997 A.2d 943, 953 (N.J. 2010)).

351. *Id.* at 1132 (citing Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 323 A.2d 495 (N.J. 1974)).

352. *Id.* In New Jersey, this is known as a *Rova Farms* claim, based on the decision in *Rova Farms Resort, Inc. v. Investors Insurance Co. of America*. *Rova Farms Resort, Inc.*, 323 A.2d at 495.

tle within the policy limits in bad faith exposing the insured to liability for any excess.[353] Based on New Jersey's limitations on the types of claims, the standard of proof required by the plaintiff, and the limitations on damages, New Jersey is deemed a "Stick" state.

New Mexico

In New Mexico, statutory provisions appear to provide for a private right of action for claimants under the statute for violations of the New Mexico Insurance Practices Act.[354] In *Sloan v. State Farm Mutual Automobile Insurance Co.*, the insureds brought an action for breach of contract, bad faith failure to settle, and a violation of the New Mexico Insurance Practices Act.[355] In the bad faith action, the district court awarded compensatory damages for the insureds' claims.[356] The insurer's appeal pertained to issues surrounding damages, but the significance to this Article's *Three Little Pigs* analogy is the recognition that New Mexico law allows for a private right of action for violations of the Insurance Practices Act, as well as permitting a claim in tort and in contract for bad faith.[357] Thus, permitting tort and contract actions for bad faith and providing a private right of action under the statute situates New Mexico as a "Stick" state.

North Carolina

In a complicated statutory scheme, the North Carolina legislature has enacted the "Unfair Claim Settlement Practices Act" to define what constitutes unfair and improper claims practices.[358] Similar to many states with codified provisions defining what constitutes "improper" claims practices, North Carolina's statute specifically rejects a private right of action for individuals.[359] The statute states explicitly that "no violation of this subsection shall of itself create any cause of action in favor of any person other than

353. *Wood*, 21 A.3d at 1132.
354. N.M. STAT. ANN. § 59A-16-30 (2000).
355. Sloan v. State Farm Mut. Auto. Ins. Co., 360 F.3d 1220 (10th Cir. 2004).
356. *Id.*
357. *See id.* at 1223–24.
358. N.C. GEN. STAT. § 58-63-15 (2011).
359. *Id.* § 58-63-15(11).

the Commissioner."[360] The statute has fourteen subparts which detail practices and acts by insurers that the North Carolina legislature recognizes as constituting unfair claims practices.[361] However, in a complex overlap of statutory provisions, the statutes do allow for a private right of action under another provision of the code, the unfair or deceptive practices statute.[362] Plaintiffs pursuing an unfair claim settlement practices violation need only show a single violation affecting them and do not need to make any additional showing.[363]

To succeed in a claim for unfair or deceptive trade practices, a plaintiff in North Carolina generally must show: "(1) defendants committed an unfair or deceptive act or practice; (2) in or affecting commerce; and (3) that plaintiff was injured thereby."[364] The Supreme Court of North Carolina has identified an unfair practice as one that "offends established public policy" and "is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers."[365] Under the statute, this includes "[n]ot attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear."[366] However, causes of action for unfair or deceptive practices are not treated the same as breach of contract actions.[367]

Additionally, the Supreme Court of North Carolina has dealt with the issue of third-party claims. Specifically, the court addressed a claim by the third party for fraudulent inducement to

---

360. *Id.*

361. *Id.* § 58-63-15.

362. N.C. GEN. STAT. §§ 75-1 to 75-49 (2011); *see also* Gray v. N.C. Ins. Underwriting Ass'n, 529 S.E.2d 676, 683 (N.C. 2000) ("[C]onduct that violates subsection (f) of [the North Carolina General Statutes] § 58-63-15(11) constitutes a violation of [the North Carolina General Statutes] § 75-1-1, as a matter of law, without the necessity of an additional showing of frequency indicating a 'general business practice.'")

363. *Gray*, 529 S.E.2d 676, 683.

364. First Atl. Mgmt. Corp. v. Dunlea Realty Co., 507 S.E.2d 56, 63 (N.C. Ct. App. 1998); s*ee also* N.C. GEN. STAT. § 75-1.1 (2011). Section 75-1.1 has been held to be preempted by the U.S. Copyright Act within the copyright context. Rutledge v. High Point Reg'l Health Sys., 556 F. Supp. 2d 611 (M.D.N.C. 2008).

365. Marshall v. Miller, 276 S.E.2d 397, 403 (N.C. 1981).

366. N.C. GEN. STAT. § 58-63-15(11)(f) (2011).

367. Boyd v. Drum, 501 S.E.2d 91, 97 (N.C. Ct. App. 1998), *aff'd per curiam*, 511 S.E.2d 304 (N.C. 1999).

sign a release in *Davis v. Hargett*.[368] The court refused to allow a third-party claim in the case, reasoning that the plaintiff had elected to ratify the fraudulent release by keeping the proceeds then suing the insurance company.[369] The court held that as a consequence of the election, the plaintiff was barred from pursuing his claim against the insurer.[370] *Davis*, however, fails to address all relevant issues associated with a third-party claim. For example, it does not reveal the likely outcome if the third party had rescinded the contract and then sought damages for the fraud and misrepresentation.

The North Carolina courts further defined and delineated the rights of first-party claimants versus third-party claimants and the application of the statutory provisions in *Wilson v. Wilson*.[371] In the case, the plaintiff brought an action against the insurer for unfair and deceptive trade practices based on the insurer's failure to settle her third-party claim under a North Carolina statute.[372] The tortfeasor was the plaintiff's husband. The wife was riding as her husband's passenger when he caused the accident. She was a co-insured on the couple's auto policy, but, in the context of this accident, she was an injured third party. In other words, the husband was the only insured (first party) for the claim, and the wife could only challenge the insurance company's actions through whatever rights North Carolina afforded to third parties.[373] The court determined that a third-party claimant—an injured spouse— could not directly pursue an unfair and deceptive trade practices action against the insurer of her husband.[374] In denying the right of the third-party claimant, the court noted that permitting such an action could create a conflict of interest for the insurer who would consequently owe duties to adverse parties—its insured and the third

368. 92 S.E.2d 782, 785–86 (N.C. 1956).

369. *Id.* at 786.

370. *Id.*

371. 468 S.E.2d 495, 496–97 (N.C. Ct. App.1996).

372. *Id.*

373. *Id.* at 498–99.

374. *Id.* at 499. While the case deals with spouses, the holding is likely not limited to those facts. The court stated, "Ms. Wilson's relationship to [the insurance company] in this case is as a third party because she seeks to recover from the insurer's liability coverage provisions for her husband, rather than from a coverage provision provided for her own interest." *Id.* at 498–99.

party.[375] As a result, North Carolina allows for first-party claims both in tort and contract, as well as provides for recovery under statutory provisions, but does not allow a third-party claimant the right to bring a direct action against an insurer—even for fraudulent inducement in the signing of a release. Therefore, North Carolina provides strong protections for the first-party claimants, but does not provide for any redress for the third-party claimant, which results in North Carolina being categorized as a "Stick" state.

North Dakota

In the North Dakota case of *Dvorak v. American Family Mutual Insurance Co.*, an injured third party alleged claims for "breach of contract, actual fraud, constructive fraud, deceit, negligence, a breach of the implied covenant of good faith, arbitrary, unreasonable, and vexatious conduct, and bad faith" based on plaintiff's assertion that the insurer's initial settlement offer was so low as to constitute bad faith.[376] The court granted summary judgment to the insurer based on a finding that it owed no duty to third-party claimants, but did have a duty to act in good faith with its policyholders.[377] The court determined that the injured third party only had a claim against the insured and not the insurer because there was no clause in the policy that gave the third party a right to sue the insurer directly.[378] Further, the court stated that the claims were not actionable under the North Dakota unfair claims practices statute because the plaintiff failed to present adequate evidence that the insurer engaged in prohibited conduct as a "general business practice."[379] However, North Dakota does recognize an action for bad faith in both tort and contract and permits claims under

375. *Id.* at 498.

376. Dvorak v. Am. Family Mut. Ins. Co., 508 N.W.2d 329, 330 (N.D. 1993) (internal quotation marks omitted).

377. *Id*. at 331.

378. *Id*.

379. *Id*. at 332–33 (citing Volk v. Wis. Mortg. Assurance Co., 474 N.W. 2d 40, 45 (N.D. 1991)); *see* N.D. CENT. CODE § 26.1-04-03(9)(a), (d) (2010 & Supp. 2011) (defining unfair settlement practices).

their unfair claims practices act if pleaded properly.[380] Nonetheless, those rights do not extend to third-party claimants.[381]

North Dakota also provides claimants opportunities for punitive damages. In *Ingalls v. Paul Revere Life Insurance Group*, the insured brought an action to recover benefits as a result of a railroad accident and for bad faith against his insurer after the insurer declared the plaintiff's policy void based upon a material misrepresentation made in the application concerning his income.[382] Judgment was entered for the plaintiff, including damages for emotional distress and punitive damages.[383] The North Dakota Supreme Court affirmed, finding that an insurer that violated its duty of good faith faced exemplary damages if it acted with the intent to injure or with a conscious disregard of the plaintiff's rights.[384] In sum, North Dakota provides substantial levels of protection for first-party claimants, qualifying it as a "Stick" state.

Ohio

Ohio has various causes of action that may give rise to bad faith claims. The Ohio Supreme Court extended a bad faith cause of action in a first-party claim for wrongful acts in a case involving an insurance company's refusal to pay its insured's medical claims.[385] In *Hoskins v. Aetna Life Insurance Co.*, the court explained that in the context of a refusal-to-settle case, the burden of proof for bad faith is on the insured.[386] Importantly, the court recognized that there are different levels of wrongdoing in bad faith cases. Bad faith might be evidenced by the mishandling of a claim, prompting extra-contractual damages—such as excess liability or consequential damages—but punitive damages arise only out of active wrongdoing.[387]

---

380. *See, e.g.*, Ingalls v. Paul Revere Life Ins. Grp., 561 N.W.2d 273, 283 (N.D. 1997) (awarding damages for emotional distress resulting from the insurer's bad faith actions).

381. *See Dvorak*, 508 N.W.2d at 331.

382. *Ingalls*, 561 N.W.2d at 275–76.

383. *Id.* at 276.

384. *Id.* at 283–84.

385. *See* Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315, 1322 (Ohio 1983).

386. *Id.* at 1320.

387. *See id.* at 1320–22.

Ohio courts recognize two types of bad faith claims: (1) a cause of action when the insurer intentionally refuses to satisfy an insured's claim when there was not a "lawful basis for the refusal coupled with actual knowledge of that fact;" or (2) a cause of action for "an intentional failure to determine whether there was any lawful basis for such refusal."[388] In *Zoppo v. Homestead Insurance Co*., the Ohio Supreme Court overruled the requirement of intent in an action for bad faith, stating that intent was not part of the reasonable justification standard.[389] By expressly overruling prior decisions, the *Zoppo* court reinstated the reasonable justification standard.[390]

In *Zoppo*, the insurer denied a claim for fire loss alleging that the insured committed arson.[391] The court reaffirmed the standard that "an insurer fails to exercise good faith in the processing of a claim of its insured where its refusal to pay the claim is not predicated upon circumstances that furnish reasonable justification therefore."[392] Further, the court rejected the notion that the bad faith cause of action requires an insured to prove that an insurer intentionally failed to investigate a claim.[393]

Following *Zoppo,* Ohio courts clarified the types of bad faith claims. In the first type of claim, the insured "must prove that the insurer had no lawful basis to deny coverage," similar to proving a breach of contract claim against the insurer.[394] In the second type of bad faith claim, similar to other states in this category, the claim is independent of the contract claim. Here, "the insured need only establish that the insurer had no reasonable justification to fail to determine whether its refusal had a lawful basis."[395]

---

388. Zoppo v. Homestead Ins. Co., 644 N.E.2d 397, 399 (Ohio 1994) (quoting Motorists Mut. Ins. Co. v. Said, 590 N.E.2d 1228, 1236 (Ohio 1992), *overruled by Zoppo*, 644 N.E. 2d 397)) (emphasis omitted) (internal quotation marks omitted).

389. *Id.* at 399–400.

390. *Id.* at 400.

391. *Id.*

392. *Id.* (quoting Staff Builders, Inc. v. Armstrong, 525 N.E.2d 783, 788 (Ohio 1988), *abrogated by Said*, 590 N.E.2d 1228)) (internal quotation marks omitted).

393. *Id.*

394. Essad v. Cincinnati Cas. Co., No. 00 CA 199, 2002 Ohio App. LEXIS 7285, at *20 (Ohio Ct. App. Apr. 16, 2002).

395. *Id.* at *21.

Additionally, Ohio has enacted unfair insurance practices statutes,[396] but like many other states, the statute creates no private cause of action and provides only administrative relief.[397] At the trial level, the finder of fact may not consider Ohio's administrative regulations governing unfair insurance practices to establish the appropriate standard of care for the carrier.[398] Furthermore, third parties are not permitted to bring a cause of action for bad faith, as there is lack of privity of contract between the insurer and the third party.[399]

As for assignment of the claim, an assignment of a right of action for bad faith to a third party is only valid when an excess judgment against a tortfeasor has already been adjudicated.[400] Thus, the excess judgment is a condition precedent to any assignment. When there has been no excess judgment, "an agreed judgment between the insured and a third party is unenforceable against an insurer."[401] Therefore, when an insurer refuses settlement, an injured third party has no right of action against the insurer for bad faith, despite an assignment, unless there is an excess judgment award against the insured.[402]

Consequently, while Ohio recognizes both tort and contract claims, it does not provide a cause of action under its unfair claims practices statutes, nor does it permit a third party to bring a direct action. Additionally, Ohio only allows an assignment after an excess judgment has been adjudicated. However, Ohio permits punitive damages against an insurer that acts in bad faith in refusing to

---

396. *See* OHIO REV. CODE ANN. §§ 3901.20–3901.21 (LexisNexis 2010 & Supp. 2010).

397. Strack v. Westfield Cos., 515 N.E.2d 1005, 1008 (Ohio Ct. App. 1986); *see* OHIO ADMIN. CODE 3901-1-07 (2011), *available at* http://codes.ohio.gov/oac/3901-1.

398. *See* Furr v. State Farm Mut. Ins. Co., 716 N.E.2d 250, 257 (Ohio Ct. App. 1998) ("[T]he jury was not misled by the incorrect jury instruction concerning the Ohio Administrative Code. . . . [A]lthough instructed that it could use violations of the . . . Code in determining whether [the insurer] acted in bad faith, the jury was not instructed that a violation would *per se* amount to a breach of good faith.").

399. *See* Gillette v. Estate of Gillette, 837 N.E.2d 1283, 1287 (Ohio Ct. App. 2005).

400. *See* Calich v. Allstate Ins. Co., No. 21500, 2004 Ohio App. LEXIS 1439, *4 (Ohio Ct. App. Mar. 31, 2004).

401. *Id.* at *4.

402. *Id.* at *5.

pay its insured's claim with a showing of sufficient proof.[403] Nevertheless, due to the above restrictions and its similarity to other "Stick" states, Ohio is deemed a "Stick" state providing moderate protections.

Oklahoma

A recent case in Oklahoma reiterates the fact that Oklahoma law permits a first-party claimant to bring a claim for bad faith in both tort and contract. In *Trinity Baptist Church v. GuideOne Elite Insurance Co.*, the insured alleged a bad faith tort claim arising from the insurer's handling of a claim for loss of property.[404] While the appeal involved the issue of whether the insured's claim was barred under a statute of limitations, the court permitted a tort claim of bad faith based on the insurer's alleged tardiness or failure to pay the coverage benefits, while also recognizing a right of action arising out of the contractual relationship.[405]

Like other states in this category, the implied duty of good faith is tied to the insurance contract itself, and a breach of the contract can result in a finding of bad faith.[406] Additionally, Oklahoma's unfair claims settlement statute does not create a private right of action,[407] and an insurer's breach of their duty does not automatically violate the statute and result in bad faith.[408] Therefore, Oklahoma permits actions for bad faith in both tort and contract for first-party claimants, but does not appear to allow third-party claimants the right to bring a direct action against an insurer.[409] This is consistent with other "Stick" states.

Rhode Island

---

403. Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315, 1320 (Ohio 1983).

404. Trinity Baptist Church v. GuideOne Elite Ins. Co., 654 F. Supp. 2d 1316, 1318 (W.D. Okla. 2009).

405. *See id.*

406. *See* Brown v. Patel, 157 P.3d 117, 121 (Okla. 2007).

407. *See* Beers v. Hillory, 241 P.3d 285, 293 (Okla. Civ. App. 2010).

408. *See* OKLA. STAT. ANN. tit. 36, § 1250.5 (West 2011); *Beers*, 241 P.3d at 294 ("An insurer may carelessly fail to perform some duty required by the statute with such frequency to warrant administrative sanction, but that does not establish more than negligent conduct in any individual case.").

409. *See* Badillo v. Mid Century Ins. Co., 121 P.3d 1080, 1113 (Okla. 2005) (Opala, J., dissenting) (per curiam).

Rhode Island also permits a first-party claimant to bring an action for bad faith in tort and contract. For example, in *Asermely v. Allstate Insurance Co.*, the plaintiff alleged that the defendant–insurer failed to pay the policy limit after judgment had been entered and that the defendant acted in bad faith.[410] The plaintiff was injured in a car accident was awarded almost $50,000 in arbitration.[411] The defendant–insurer rejected this result and a jury awarded the plaintiff more than $85,000.[412] Disappointed by this result, the defendant–insurer then attempted to settle the case for $50,000.[413] The plaintiff's action alleging bad faith followed, in which the plaintiff brought the claim in both tort and contract. While the court remanded the action, it also announced a clear rule regarding insurers' duties when dealing with third-party claimants. It stated that the "fiduciary obligation to act in the best interests of its insured" to avoid excess liability and properly protect the insured "extends not only to the insurance company's own insured, but also . . . to a party to whom the insureds have assigned their rights."[414] For the court, it was no longer "sufficient that the insurance company act in good faith."[415]

In defining its standard, Rhode Island has expressly stated that the issue of whether the insurer committed bad faith for refusing to settle is to be a question of fact determined by the trier of fact, as opposed to most states which make that inquiry a question of law.[416] The Rhode Island Supreme Court has also recognized that the insured may recover punitive damages where appropriate.[417]

Interestingly, in further delineating the duties of the insurer, in *DeMarco v. Travelers Insurance Co.*, the court held that:

---

410. Asermely v. Allstate Ins. Co., 728 A.2d 461 (R.I. 1999) (per curiam).

411. *Id.* at 462.

412. *Id.*

413. *Id.* at 462–63.

414. *Id.* at 464.

415. *Id.*

416. *See* R.I. GEN. LAWS § 9-1-33 (1997), *preempted by* ERISA, 29 U.S.C. § 1144 (2006), *as recognized in* Desrosiers v. Harford Life & Accident Ins. Co., 354 F. Supp. 2d 119 (D.R.I. 2005); Skaling v. Aetna Ins. Co., 799 A.2d 997, 1010 (R.I. 2002).

417. Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980).

> [W]hen an insurer is faced with multiple claimants with claims that in the aggregate exceed the policy limits, the insurer has a fiduciary duty to engage in timely and meaningful settlement negotiations in a purposeful attempt to bring about settlement of as many claims as is possible, such that the insurer will thereby relieve its insured of as much of the insured's potential liability as is reasonably possible given the policy limits and the surrounding circumstances.[418]

Essentially, the court held that the insurer has a fiduciary duty to settle as many claims as possible, thereby not exposing its insured to possible excess judgments. Rhode Island qualifies as a "Stick" state due to its adoption of the narrower bad faith standard, despite providing for actions in both tort and contract.

South Carolina

One of the first cases to contemplate a bad faith action occurred in South Carolina and it remains the law of the state.[419] In *Tyger River Pine Co. v. Maryland Casualty Co.*, the insured brought an action against its insurer to recover the amount it paid to an employee in a judgment that exceeded its insurance policy limit.[420] While the employee offered "to settle the claim at a small and reasonable figure which a person of ordinary prudence would have accepted," the insurer rejected the offer, thereby exposing the insured to the excess judgment.[421] The insured alleged that the loss was suffered because the insurer neglected and refused to settle the claim before suit, and that the insurer acted in bad faith.[422] The South Carolina Supreme Court determined that the question of whether the insurer acted in good faith when it refused to settle was a question for the jury—and the jury found that the insurer did not act in good faith—which was upheld on review.[423] Therefore,

418. DeMarco v. Travelers Ins. Co., 26 A.3d 585, 613–14 (R.I. 2011).
419. *See* Tyger River Pine Co. v. Md. Cas. Co., 170 S.E. 346 (S.C. 1933).
420. *Id.* at 346–47.
421. *Id.* at 347.
422. *Id.*
423. *Id.* at 349.

South Carolina permits an action for bad faith in both tort and contract.

Additionally, South Carolina has an unfair claims practices statute.[424] Like other states, the case law has interpreted the statute to preclude a private right of action.[425] Also, while South Carolina does not permit the third-party claimant to bring a direct action against the insurer for bad faith, South Carolina has recognized that a third party may bring a direct action against an insurer for fraud and misrepresentation if the claimant can prove liability on the underlying tort.[426] Moreover, South Carolina has the right of assignment from first parties to third parties under the "*Tyger River* doctrine."[427] This doctrine permits the third party to step into the shoes of the insured and bring the insured's tort and breach of contract claims in consideration of a covenant not to execute an excess judgment against an insured. As a result, South Carolina comes very close to qualifying as a "Brick" state, but in contrast to the broader protections offered by the states in that category—especially with regard to direct actions by third parties against insurers for bad faith—South Carolina is categorized as a "Stick" state.

South Dakota

In the analysis, South Dakota qualifies as a "Stick" state based on its recognition of the right of first-party claimants to bring an action for bad faith in both tort and contract. Under South Dakota law, a claim for bad faith is an action in tort and is entirely separate from the contractual claim for policy limits.[428] In *Champion v. United States Fidelity & Guaranty Co.*, the Supreme Court of South Dakota adopted a two-prong test to prove first-party bad

---

424. S.C. CODE ANN. § 38-59-20 (2002).

425. *See* Masterclean, Inc. v. Star Ins. Co., 556 S.E.2d 371, 377 (S.C. 2001) (finding a private right of action did not exist under South Carolina's Insurance Trade Practices Act, as well as the Claims Practice Act).

426. *See* Gaskins v. S. Farm Bureau Cas. Ins. Co., 581 S.E.2d 169, 170–71 (S.C. 2003).

427. Smith v. Md. Cas. Co., 742 F.2d 167, 168 (4th Cir. 1984); *see Tyger River Pine Co.*, 170 S.E. 346.

428. Champion v. U.S. Fid. & Guar. Co., 399 N.W.2d 320, 322–23 (S.D. 1987).

faith.[429] The court held that the "absence of a reasonable basis for denial," coupled with a "knowledge or reckless disregard of a reasonable basis," amounted to first-party bad faith.[430] The court explained that application of the bad faith test required a determination of whether a claim was properly investigated, evaluated, and reviewed.[431] However, the court went on to permit an insurer to challenge claims which are "fairly debatable and will be found liable only where it has intentionally denied (or failed to process or pay) a claim without a reasonable basis."[432]

Another aspect for consideration in determining avenues of recovery for claimants is the availability of punitive damages for bad faith claims and the possibility of attorneys' fees. South Dakota law allows plaintiffs, in certain circumstances, to recover punitive damages.[433] Also, South Dakota has a statute that authorizes recovery of attorneys' fees when an insurer's refusal to pay the full amount of the loss is "vexatious or without reasonable cause."[434]

Nonetheless, in *Kirchoff v. American Casualty Co.*, the United States Court of Appeals for the Eighth Circuit held that punitive damages are not available in breach of contract claims only based on an insurance policy under South Dakota law.[435] In a 2011 case, *Berry v. Time Insurance Co.*, the United States District Court for the District of South Dakota addressed bad faith claims under state law and the issue of punitive damages.[436] The court found that the plaintiff had sufficiently pleaded her bad faith claim in asserting that the defendants "knew there was not, or acted in reckless disregard to having, a reasonable basis for denying the claim."[437] Additionally, the plaintiff alleged that the insurer's refusal to honor the policy was "willful, vexatious and without reasonable basis,

---

429. *Id.* at 323–24.

430. *Id.* at 324 (quoting Travelers Ins. Co. v. Savio, 706 P.2d 1258, 1275 (Colo. 1985)) (internal quotation marks omitted)

431. *Id.*

432. *Id.* (quoting *Travelers*, 706 P.2d at 1275).

433. Dahl v. Sittner, 474 N.W.2d 897, 900 (S.D. 1991).

434. S.D. CODIFIED LAWS § 58-12-3 (2004 & Supp. 2011); *see also Dahl*, 474 N.W.2d at 900 ("Claims for punitive damages are prohibited in this state unless expressly authorized by statute.").

435. Kirchoff v. Am. Cas. Co., 997 F.2d 401, 406 (8th Cir. 1993).

436. Berry v. Time Ins. Co., 798 F. Supp. 2d 1015 (D.S.D. 2011).

437. *Id.* at 1021.

resulting in substantial damages to [the plaintiff.]"[438] Consequently, the court held that while punitive damages are not an independent cause of action, they can be awarded in addition to compensatory damages on the plaintiff's bad faith claim.[439] Therefore, South Dakota recognizes an insured's right to bring an action in both tort and contract with the possibility for punitive damages against the insurer on the bad faith tort claim. Thus, South Dakota meets the criteria of a "Stick" state.

Texas

Texas is another jurisdiction that recognizes the tort of bad faith.[440] In order for an insured to establish the tort of bad faith in Texas, it "must prove: (1) the absence of a reasonable basis for denying or delaying payment of the benefits of the policy *and* (2) that the carrier knew or should have known that there was not a reasonable basis for denying the claim or delaying payment of the claim."[441] However, as long as the insurer has a reasonable basis to deny or delay payment of the claim, even if the basis eventually is determined by the fact-finder to be erroneous, the insurer is not liable for the tort of bad faith.[442] There are many states that adopt similar standards regarding the insurer's defense to a bad faith claim. Additionally, under Texas law, a breach of the contract is a prerequisite to an insured's bad faith claim.[443]

In a recent case, *Great American Insurance Co. v. AFS/IBEX Financial Services*, the United States District Court for the Northern District of Texas reiterated that an insurer is liable for both common law bad faith claims as well as violations of the Texas Insurance Code if it "knew or should have known that it was reasonably clear that the claim was covered."[444] In Texas, the

438. *Id.* (internal quotation marks omitted).

439. *Id.* at 1022.

440. *See* Lyons v. Millers Cas. Ins. Co. of Tex., 866 S.W.2d 597 (Tex. 1993).

441. *Id.* at 600 (quoting Aranda v. Ins. Co. of N. Am., 748 S.W.2d 210, 213 (Tex. 1988)).

442. *Id.*

443. Liberty Nat'l Fire Ins. Co. v. Akin, 927 S.W.2d 627, 629 (Tex. 1996).

444. Great Am. Ins. Co. v. AFS/IBEX Fin. Servs., Inc., No. 3:07-CV-924-O, 2011 WL 3163605, at *3 (N.D. Tex. July 27, 2011) (quoting Liberty Mut.

standard for common law and statutory breach of good faith are the same.[445] An insurer does not breach its duty of good faith and fair dealing merely by erroneously denying a claim; rather "an objective standard allows courts to determine 'whether a reasonable insurer under similar circumstances would have delayed or denied payment of the claim.'"[446] The focus is on the reasonableness of the insurer's conduct in handling the claim.[447] Whether the insurer's actions were reasonable is a question of fact for a jury.[448] Thus, Texas law has recognized both common law and statutory claims for bad faith, including holding an insurer "liable for damages for breach of its duty of good faith . . . when the insurer fails to attempt to effectuate a settlement where its liability has become reasonably clear or where it fails to reasonably investigate a claim in order to determine whether its liability is reasonably clear."[449] Based on the foregoing, Texas constitutes a "Stick" state.

Vermont

In *Bushey v. Allstate Insurance Co.*, the plaintiff brought an action for bad faith against his insurer for failure to settle his underinsured motorist claim.[450] On appeal, the Supreme Court of Vermont affirmed the trial court's grant of summary judgment, finding that the trial court had properly concluded that the insured's claim was "fairly debatable" as a matter of law.[451] Thus, it was not necessary for the trial court to address the insurer's alleged bad faith.[452] Nonetheless, while the insured failed on appeal, Vermont law recognized the plaintiff's ability as a first-party claimant to bring his bad faith action in both tort and contract arising out of

---

Ins. Co. v. Mid-Continent Ins. Co., 405 F.3d 296, 309 (5th Cir. 2005)) (internal quotation marks omitted).

445. Mid-Century Ins. Co. of Tex. v. Boyte, 80 S.W.3d 546, 549 (Tex. 2002).

446. *Great Am. Ins. Co.*, 2011 WL 3163605, at *3 (quoting Aleman v. Zenith, 343 S.W.3d 817, 822 (Tex. App. 2011)).

447. *Id.*

448. *Id.*

449. Luna v. Nationwide Prop. & Cas. Ins. Co., 798 F. Supp. 2d 821, 830 (S.D. Tex. 2011).

450. Bushey v. Allstate Ins. Co., 670 A.2d 807 (Vt. 1995).

451. *Id.* at 810–11.

452. *Id.* at 811.

the contractual relationship with his insurer. Additionally, federal courts interpreting Vermont state insurance law have held that punitive damages may be appropriate when the insurer has exhibited gross misconduct or reckless disregard toward the plaintiff.[453]

Additionally, Vermont has enacted statutes addressing unfair trade practices.[454] In a lawsuit involving the declaration of coverage under the Vermont Insurance Trade Practices Act, the United States District Court for the District of Vermont held that while a provision of the act provided "'administrative sanctions for unfair and deceptive acts within the insurance industry, including for unfair claim settlement practices, . . . the Act does not create a private right of action.'"[455] Thus, Vermont law permits an insured to bring a bad faith claim in both tort and contract, but does not permit a private right of action under the insurance trade practice statute, similar to other states in this category, qualifying Vermont as a "Stick" state.

Wisconsin

In *Anderson v. Continental Insurance Co.*, the Wisconsin Supreme Court laid out the elements of a bad faith claim under state law, permitting claims in both tort and contract.[456] As a result, Wisconsin meets the criteria of a "Stick" state by providing moderate levels of protection for claimants. In *Anderson*, the plaintiff–insured brought an action against the insurer seeking compensatory and punitive damages for the company's allegedly tortuous conduct in failing to fulfill its contractual obligations.[457] The trial court dismissed the suit, but the appellate court reversed and remanded, concluding that an insured could assert a bad faith cause of action in tort against an insurer for refusing to handle the insured's

453. Davis v. Liberty Mut. Ins. Co., 19 F. Supp. 2d 193, 203 (D. Vt. 1998).

454. VT. STAT. ANN. tit. 8, § 4724 (2005 & Supp. 2011).

455. City of Burlington v. Hartford Steam Boiler Inspection & Ins. Co., 190 F. Supp. 2d 663, 684 (D. Vt. 2002) (alteration in original) (quoting Larocque v. State Farm Ins. Co., 660 A.2d 286, 288 (Vt. 1995)), *aff'd sub nom.* City of Burlington v. Indem. Ins. Co. of N. Am., 346 F.3d 70 (2d Cir. 2003).

456. Anderson v. Cont'l Ins. Co., 271 N.W.2d 368, 376–79 (Wis. 1978).

457. *Id.* at 371–72.

claim.[458] The Wisconsin Supreme Court held that there is a separate tort of bad faith which results from breaching the duty implied in the contractual relationship.[459] Here, the plaintiff had to show the insurer's "knowledge or reckless disregard of the lack of a reasonable basis for denying or refusing to honor or negotiate on an insured's claim."[460]

While Wisconsin was one of the first states to follow California in recognizing tort causes of action for bad faith in first-party cases, the court defined the cause of action more narrowly than the California Supreme Court did in *Gruenberg*.[461] *Anderson* stated that it is the plaintiff's burden to show "the absence of a reasonable basis for the denial of benefits" and that once that is shown, "the defendant's knowledge or reckless disregard for the lack of a reasonable basis for den[ial]" makes bad faith rise to the level of an intentional act.[462] Therefore, Wisconsin permits bad faith actions in both tort and contract; however, subsequent cases defined the cause of action more narrowly, resulting in moderate protection for claimants, but less than states in the "Brick" state category.

Nonetheless, Wisconsin recognizes three types of bad faith claims:

> (1) An insured may bring a bad faith action against the insurance company for failing to settle the claim with a third-party claimant when the ultimate judgment exposes the insured to a judgment in excess of the policy limits. This type of claim is known as a third-party bad faith claim. (2) An insured may bring a bad faith action when the insurer unreasonably and in bad faith withholds payment of the claim of its insured. This type of claim is known as a first-party bad faith claim. (3) A claimant may have a bad faith action against an insurance company based on the insurance company's failure to reim-

458. *Id.* at 371.

459. *Id.* at 374.

460. *Id.* at 378.

461. *See supra* text accompanying notes 43–45. *Compare Anderson*, 271 N.W.2d 368, *with* Gruenberg v. Aetna Ins. Co., 510 P.2d 1032 (Cal. 1973) (en banc).

462. *Anderson*, 271 N.W.2d at 376.

> burse the claimant for a worker's compensation claim.[463]

Thus, Wisconsin qualifies as a "Stick" state.

Wyoming

The Supreme Court of Wyoming, in *McCullough v. Golden Rule Insurance Co.*, determined whether to recognize first-party bad faith tort claims and the standard of proof necessary to prevail on such claims.[464] In *McCullough*, the plaintiff brought the action after the insurer denied the insured's claims for surgical bills.[465] The court held that the law of Wyoming recognized an independent tort for violating the implied duty of good faith and fair dealing in an insurer's policy for its insured.[466] The court noted that the independent tort was "structurally consistent" with state law.[467] Further, the court held that "the appropriate test to determine bad faith is the objective standard whether the validity of the denied claim was not fairly debatable."[468] The court also held that any award of punitive damages requires evidence of wanton or willful misconduct.[469] Thus, Wyoming recognized the availability of the tort of bad faith for first-party claimants and held that an insurer owed a duty of good faith to its insured not to unreasonably deny a claim for policy benefits, the breach of which may give rise to the tort action. In doing so, Wyoming permitted first-party actions in tort and contract but did not recognize any right of the third-party claimant to bring a direct action against the insurer, leaving Wyoming as a "Stick" state.

In conclusion, the majority of states fall into the category of "Stick" states. Even as the specifics vary from state to state, these states have common elements of providing for actions in both tort and contract, as well as providing broad statutory provisions defining unfair claims settlement practices. In some of these states, pri-

---

463. Roehl Transp., Inc. v. Liberty Mut. Ins. Co., 784 N.W.2d 542, 550–51 (Wis. 2010) (footnotes omitted) (internal quotation marks omitted).

464. McCullough v. Golden Rule Ins. Co., 789 P.2d 855 (Wyo. 1990).

465. *Id.* at 856.

466. *Id.* at 858.

467. *Id.*

468. *Id.* at 860.

469. *Id.* at 860–61.

vate rights of action are available by statute. Accordingly, these states provide more protections for first-party claimants as compared to those states deemed "Straw" states. As a rule, however, these states provide few protections for third-party claimants, particularly with regard to direct actions against insurers. Some "Stick" states also provide for assignment of first-party claims to third parties in consideration of covenants not to execute or similar compensation. Defining bad faith to permit claims in both tort and contract provides claimants with at least moderate protections against the mishandling of claims and the possibility of punitive damages, which is why these states have been deemed "Stick" states. As "Stick" states, these states offer a bit more resistance to the might of the big, bad wolf than "Straw" states.

C. Houses of Brick

Concluding the analogy, "Houses of Brick" are represented by states that have endorsed the broadest definition and application of bad faith, including recognizing actions in tort as well as contract, in contrast to the states above which either offer only actions in contract—"Straw"—or offer tort and contract claims—"Sticks"—which are sometimes limited. What truly distinguishes these states, however, is that they have some form of third party claims provided by either statute or common law. This distinction is significant to differentiate the states detailed above which offer no rights to third parties or only limited causes of action. Often, it is the third party who is the most aggrieved when injured by an insured and treated unfairly by the insureds' insurer. As the insurer is not in privity of contract with the third party, therefore owing no duty arising out of the contract, it is the third party who often receives the "worst" treatment—i.e., delays or denials in paying claims. The insurer has no incentive to act promptly to pay the claim of the third party without the fear of a bad faith claim. Thus, the possibility of a "third party" bad faith action is a strong motivation for the insurer to treat the third party fairly. As a result,these states offer the most protections to parties injured by the unfair or improper claims practices of insurers. The "Brick House" states are Alabama, California, Florida, Iowa, Kentucky, Louisiana, Michigan, Montana, Washington, and West Virginia.

Alabama

Beginning with Alabama, the Alabama Supreme Court, in *National Security Fire & Casualty Co. v. Bowen*, outlined the following as necessary elements of a bad faith claim:

> (a) an insurance contract between the parties and a breach thereof by the defendant; (b) an intentional refusal to pay the insured's claim; (c) the absence of any reasonably legitimate or arguable reason for that refusal (the absence of a debatable reason); (d) the insurer's actual knowledge of the absence of any legitimate or arguable reason; [and] (e) if the intentional failure to determine the existence of a lawful basis is relied upon, the plaintiff must prove the insurer's intentional failure to determine whether there is a legitimate or arguable reason to refuse to pay the claim.[470]

The court further stated that an insurer is liable for "refusal to pay a [first-party] claim when there is no lawful basis for the refusal coupled with actual knowledge of that fact."[471] Like other states, the court defined "no lawful basis" as an insurer's lack of a "legitimate or arguable reason" for not paying the claim.[472]

Another consideration in whether the insurer's actions rise to the level of constituting bad faith is the concept of a "fairly debatable" claim. A claim is "fairly debatable," when the insurer is entitled to debate it, regardless of it being a question of fact or a question of law.[473] An insurer's nonpayment is not enough to show bad faith. Instead, the insured must prove "nonpayment without any reasonable ground for dispute," that the insurer had no defense to the insured's claim.[474] Additionally, the court stated that to make out a prima facie case for a bad faith refusal to pay claim, the plaintiff must show sufficient evidence to garner a directed verdict on the contract claim.[475]

---

470. Nat'l Sec. Fire & Cas. Co. v. Bowen, 417 So. 2d 179, 183 (Ala. 1982).

471. *Id.*

472. *Id.*

473. *Id.*

474. *Id.*

475. Nat'l Sav. Life Ins. Co. v. Dutton, 419 So. 2d 1357, 1362 (Ala. 1982).

Nevertheless, in contrast to every other state, Alabama has two categories of bad faith. In *Pyun v. Paul Revere Life Insurance Co.*, the United States District Court for the Northern District of Alabama discussed the various types of bad faith claims.[476] Under what Alabama recognizes as "ordinary" bad faith, a plaintiff must prove the existence of a valid insurance contract and an intentional breach by the insurer without any "reasonably legitimate or arguable reason" for the refusal to pay, and the insurer's actual knowledge that there is no legitimate reason.[477] Additionally, if the plaintiff makes the claim of intentional refusal, he will have to prove that the insurer intentionally failed to determine a legitimate reason for the denial.[478] This type of claim is reserved for extreme cases as recognized under the law.[479]

Conversely, ordinary bad faith is distinguished from what Alabama law calls "extraordinary" bad faith.[480] Under "extraordinary" bad faith, an insured must show simply that the insured failed to properly investigate the claim or have it reviewed and that the refusal to pay amounted to a breach of the insurance contract.[481] This type of bad faith arises when there is an:

> (1) intentional or reckless failure to investigate a claim, (2) intentional or reckless failure to properly subject a claim to cognitive review, (3) the manufacture of a debatable reason to deny a claim, or (4) reliance on an ambiguous portion of a policy as a lawful basis for denying a claim.[482]

As for the treatment of third-party claimants, Alabama has applied the following law. In *Williams v. State Farm Mutual Automobile Insurance Co.*, the Alabama Supreme Court stated that "it is well established that a party cannot bring an action against an

---

476. Pyun v. Paul Revere Life Ins. Co., 768 F. Supp. 2d 1157, 1169–70 (N.D. Ala. 2011).

477. *Id.* at 1169–70.

478. *Id.*

479. *Id.* at 1170 (citing Shelter Mut. Ins. Co. v. Barton, 822 So. 2d 1149, 1154 (Ala.2001)).

480. *See id.*at 1170–71.

481. *Id.* at 1170.

482. *Id.* (citing Singleton v. State Farm Fire & Cas. Co., 928 So. 2d 280, 283 (Ala. 2005)).

insurance company for bad-faith failure to pay an insurance claim if the party does not have a direct contractual relationship with the insurance company."[483] The *Williams* court distinguished the holding in *Howton v. State Farm Mutual Automobile Insurance Co.*, which acknowledged "the fundamental and well-established general principle that an accident victim (a third party to a liability insurance contract) cannot maintain a direct action against the insurer for the alleged liability of the insured where the legal liability of the insured has not been determined by judgment."[484] However, the *Howton* court also held that there was a direct action for a third party against an insurer if "the insurer undertakes a *new and independent obligation* directly with a nonparty to the insurance contract in its efforts to negotiate a settlement of the third party's claim."[485] "A 'new and independent obligation' exists when 'the insurer, acting independently of its insured, enters into a contract with, or commits a tort against, a third-party claimant.'"[486] Therefore, Alabama has some form of protection for the third-party claimant, albeit, one restricted to situations in which the third party and the insurer have entered into a "new and independent obligation." As such, Alabama's unique treatment of bad faith, as well as its protection for the third-party claimant, categorizes Alabama as a "Brick" state.

California

California has long recognized bad faith as a cause of action.[487] Like many jurisdictions, the tort of bad faith under California law has two elements. First, an insurer must withhold some kind of benefit under the policy.[488] Second, the tort requires the withholding to be "without proper cause."[489] California is an early

483. Williams v. State Farm Mut. Auto. Ins. Co., 886 So. 2d 72, 75–76 (Ala. 2003).

484. *Williams*, 886 So.2d at 74 (quoting Howton v. State Farm Mut. Auto. Ins. Co., 507 So. 2d 448, 450 (Ala. 1987) (per curiam)) (internal quotation marks omitted).

485. *Id.* at 74–75 (quoting *Howton*, 507 So. 2d at 450–51) (internal quotation marks omitted).

486. *Id.* at 75. (quoting *Howton*, 507 So. 2d at 450).

487. *See* Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1038 (Cal. 1973).

488. Love v. Fire Ins. Exch., 271 Cal. Rptr. 246, 255 (Cal. Ct. App. 1990).

489. *Id.*

pioneer in the area of bad faith, and, more particularly, excess liability. In addition to identifying the elements of a bad faith claim early on, California also recognized that a bad faith claim may exist for breach of the duty of the insurer to defend an action, including failing to provide independent counsel to an insured where a conflict may exist between the insurer and its insured.[490] Furthermore, California recognizes a first-party tort action for bad faith as well as an action in contract, and also permits assignment of an insured's bad faith claim to a third-party claimant.[491]

California law continues to wrestle with the rights of third-party claimants, however. In *Moradi-Shalal v. Fireman's Fund Insurance Cos.*, the California Supreme Court limited a third-party litigant's right to bring an action to impose civil liability on an insurer for engaging in unfair claims settlement practices.[492] In the case, the third party settled an insurance claim against the insured and it was dismissed with prejudice.[493] The third party then filed a complaint against defendant insurer for violations of the California Insurance Code, alleging the insurer refused to settle her claim promptly and fairly.[494] The court held that the plaintiff must first obtain a judicial determination of the insured's liability as a condition precedent to bringing an action as a private litigant in order to impose civil liability on an insurer for engaging in unfair claims settlement practices.[495] This decision greatly limited the injured party's ability to bring a direct action against the insurer for unfair claims practices.

Despite legislative efforts to give third parties more protection, the California legislature rejected the "Fair Insurance Responsibility Act of 2000."[496] This act would have given third-party plaintiffs the right to sue a tortfeasor's insurance company for bad

---

490. *See* Sierra Pac. Indus. v. Am. States Ins. Co., No. 2:11-cv-00346-MCE-JFM, 2011 WL 2935878, at *4–5 (E.D. Cal. July 18, 2011).

491. *See Gruenberg*, 510 P.2d at 1037; Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198 (Cal. 1958).

492. Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58 (Cal. 1988).

493. *Id.* at 60.

494. *Id.*

495. *Id.* at 74.

496. 1999 Cal. Stat. 720 (1999); *see* CAL. CIV. CODE §§ 2870, 2871 (West Supp. 2011) (noting the proposition's rejection).

faith in limited situations.[497] Today, third-party claimants have no private right action for bad faith for commission of any unfair claims settlement practice specified under California's Insurance Code.[498] The law of third party bad faith is still somewhat unsettled, though; a third party has some rights under the common law, but no statutory right of action.[499]

The Supreme Court of California specifically addressed actions brought by injured third-party claimants under the statute in *California State Automobile Association Inter-Insurance Bureau v. Superior Court*.[500] Here, the court noted that in *Moradi-Shalal* it held that "a final judicial determination of the insured's liability [for the third party claimant's injuries] is a condition precedent to a[n] . . . action against the insurer," but there were still questions left unanswered regarding the rights of third parties.[501] The court went on to address whether a *stipulation* of the insured's liability signed by the insurer, insured, and third party claimant, and entered as a judgment, satisfied the condition precedent as set forth in *Moradi-Shalal*.[502] Previously, the court had contemplated the appropriateness of allowing such suits due to concerns over practical and policy problems, creating disincentives for settlements and benefits by allowing suits by third parties which may also create conflicts of interest.[503] The *Automobile Association Inter-Insurance Bureau* court held that a stipulated judgment under these

---

497. Fair Insurance Responsibility Act of 2000, 1999 Cal. Stat. 720.

498. CAL. INS. CODE § 790.03 (West 2005 & Supp. 2011); Bates v. Harford Life & Accident Ins. Co., 765 F. Supp. 2d 1218 (C.D. Cal. 2011) (holding that California's "Unfair Insurance Practices Act" does not create a private civil case of action for first- or third-party claimants against an insure that commits one of the various acts listed in section 790.03).

499. *Compare* Misathaphone v. GEICO Gen. Ins. Co., No. B220888, 2011 WL 2811460 at *7–8 (Cal Ct. App. July 7, 2011) (allowing a permissive user to file an action directly against the insurer under the circumstances, while the injured party was also bringing a bad faith claim pursuant to an assignment), *with Bates*, 765 F. Supp. 2d at 1221 (holding there was no private third party right of action under the statute).

500. 788 P.2d 1156 (Cal. 1990).

501. *Id.* at 1157 (first alteration in original) (quoting Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58, 75 (Cal. 1988)) (internal quotation marks omitted).

502. *Id.*

503. *Id.* at 1158.

circumstances constituted a "judicial determination" as required by *Moradi-Shalal*, enabling a third-party claimant to bring a pre-*Moradi-Shalal* code claim.[504]

In another development, the 2011 case *Mitsathaphone v. GEICO General Insurance Co.* concerned a permissive user–plaintiff involved in a single car accident who was sued by the passengers in the vehicle.[505] The permissive user alleged causes of action for bad faith that the insurer "breached the implied covenant of good faith and fair dealing by failing to provide an adequate defense, failing to reasonably adjust and settle [her] claim, failing to timely investigate and accept [a] conditional policy limits demand, failing to communicate the demand" to the insured or to the plaintiff as a permissive user, and failing to provide an adequate defense.[506] The vehicle was insured by the defendant insurer, which was in privity of contract with the owner, and the plaintiff was covered under the policy only because she was a permissive user.[507] The injured passenger also sued the insurer for bad faith pursuant to the plaintiff's assignment of her claims against the insurer.[508] As the injured passenger's bad faith claims, which were under assignment from the plaintiff, rested on the same basic allegations as the permissive user's claims, the California Court of Appeals held that both complaints could proceed against the insurer.[509] While this is technically not a third-party action, the court allowed the permissive user to file an action directly against the insurer under the circumstances, while the injured party was also bringing a bad faith claim pursuant to an assignment. California is a state which is difficult to categorize under this Article's analogy, but the fact that California law provides some rights for the third-party claimant to bring a direct action against an insurer, as well as permits a bad faith claim in tort and contract, validates California's classification as a "Brick" state.

Florida

504. *Id.* at 1160.

505. Mitsathaphone v. GEICO Gen. Ins. Co., No. B220888, 2011 WL 2811460, at *1 (Cal Ct. App. July 7, 2011).

506. *Id.* at *4.

507. *Id.* at *2.

508. *Id.* at *1.

509. *Id.* at *9.

Florida does not recognize a common law "bad faith" cause of action against a first-party insurer and thus would not seem to qualify as a "Brick" state.[510] However, in 1982, the Florida Legislature enacted section 624.155 of the Florida Statutes,[511] referred to as the "Civil Remedy Statute," becoming the first in the United States to create the right to bring a private lawsuit for an insurance company's violations of the Unfair Insurance Trade Practices Act.[512] Since the enactment, Florida courts have interpreted the statute to authorize first-party "bad faith" legal actions.[513] *Opperman v. Nationwide Mutual Fire Insurance Co.* was the first such Florida appellate decision, holding:

> [T]he plain meaning of section 624.155(1)(b) extends a cause of action to the first party insured against its insurer for bad faith refusal to settle. The language of section 624.155 is clear and unambiguous and conveys a clear and definite meaning. It provides a civil cause of action to "any person" who is injured as a result of an insurer's bad faith dealing.[514]

The statute provides outside-the-contract remedies for consumers.[515] Specifically, the Civil Remedy Statute cross references another Florida statute entitled the "Unfair Claims Settlement Practices Act,"[516] which lists specific conduct which may give rise to a claim.[517] Moreover, the Civil Remedy Statute exposes insurers to the risk that a jury may award punitive damages should they conclude that the insurer: (1) acted willfully, wantonly, and malicious-

---

510. *See* State Farm Mut. Auto. Ins. Co. v. LaForet, 658 So.2d 55, 62 (Fla. 1995) ("[F]irst]-party bad faith actions are actionable only under [the statute] and not the common law.").

511. FLA. STAT. ANN. § 624.155 (West 2004 & Supp. 2012).

512. *Id.*

513. *See* Opperman v. Nationwide Mut. Fire Ins. Co., 515 So.2d 263 (Fla. Dist. Ct. App. 1987).

514. *Id.* at 266.

515. FLA. STAT. ANN. § 624.155.

516. FLA. STAT. ANN. §§ 624.155, 626.9541(1)(i) (West 2004 & Supp. 2011).

517. FLA. STAT. ANN. § 626.9541(1)(i).

ly with respect to any person claiming damage under the statute; or (2) in reckless disregard of the rights of one of its insureds.[518] In addition to protections for claimants, the statute provides some protections for the insurer, as it requires that a sixty-day statutory notice be filed in advance of any bad faith lawsuit, and it bars a bad faith lawsuit if payment is made within that time.[519]

Further delineating Florida bad faith law, in *State Farm Mutual Automobile Insurance Co. v. LaForet*, the Florida Supreme Court rejected the "fairly debatable" standard, which states that a claim for bad faith can succeed only if the plaintiff can show the absence of a reasonable basis for denying the claim.[520] Florida differs from most jurisdictions given that first-party bad faith actions are actionable *only* under statute and not the common law, thus the "fairly debatable" test was unnecessary.[521] The statute provides an insurer has acted in bad faith if it has "[n]ot attempt[ed] in good faith to settle claims when, under all the circumstances, it could and should have done so, had it acted fairly and honestly toward its insured and with due regard for [the insured's] interests."[522] Perhaps the most distinguishing feature of the Florida statute—and why Florida is deemed a "Brick" state—is that the statute provides for a direct action for bad faith by "any person . . . against an insurer when such person is damaged" including actions by third-party claimants.[523] Florida is unique in both its statute and its extension of statutory claims to third-party claimants, and therefore qualifies as a "Brick" state.

Iowa

Iowa is also a "Brick" state. Iowa recognizes a common law cause of action against an insurer for bad faith denial or delay of insurance benefits in addition to a breach of contract claim.[524]

---

518. FLA. STAT. ANN. § 624.155(5)(a)–(c).

519. *Id.*

520. State Farm Mut. Auto. Ins. Co. v. LaForet, 658 So.2d 55, 62–63 (Fla. 1995).

521. *Id.*

522. *Id.* at 62 (alterations in original) (quoting FLA. STAT. ANN. § 624.155(1)(b)(1)).

523. FLA. STAT. ANN. § 624.155(1).

524. *See* Dolan v. Aid Ins. Co., 431 N.W.2d 790, 794 (Iowa 1988) ("[I]t is appropriate to recognize the first-party bad faith tort to provide the insured an

In *Dolan v. Aid Insurance Co.*, the Supreme Court of Iowa addressed the issue of whether Iowa would recognize a first-party cause of action in tort against an insurer where it had already recognized a cause of action against an insurer for bad faith in its representation of an insured against a third-party claim.[525] The *Dolan* court held that traditional contract damages were insufficient to adequately compensate an insured for an insurer's conduct that amounts to bad faith.[526]

Similar to other states, an insured must show that the insurer denied the claim without a reasonable basis and that the insurer knew, or had reason to know, of the lack of reasonable basis.[527] The first element is objective while the second element is subjective.[528] "A reasonable basis exists for denying insurance benefits if the claim is 'fairly debatable' as to either matters of fact or law."[529] Fairly debatable means the claim "is open to dispute on any logical basis."[530] Whether a claim is "fairly debatable" can generally be determined by the court as a matter of law.[531] "[If] an objectively reasonable basis for denial of a claim *actually exists*, [then] the insurer cannot be held liable for bad faith as a matter of law."[532] Based on this test, if the court determines that the insurer had no reasonable basis upon which to deny a claim, it must then determine if the insurer knew, or should have known, that the basis for denying the insured's claim was unreasonable.

Iowa also has an Unfair Claims Practices Act, which provides detailed descriptions of actions by insurers that constitute

---

adequate remedy for an insurer's wrongful conduct. . . . [T]his recognition is also justified by the nature of the contractual relationship between the insurer and insured.").

525. *Id.* at 790.

526. *Id.* at 794.

527. McIlravy v. N. River Ins. Co., 653 N.W.2d 323, 329 (Iowa 2002).

528. Bellville v. Farm Bureau Mut. Ins. Co., 702 N.W.2d 468, 473 (Iowa 2005) (citing Reuter v. State Farm Mut. Auto. Ins. Co., 469 N.W.2d 250, 253 (Iowa 1991)).

529. Gibson v. ITT Hartford Ins. Co., 621 N.W.2d 388, 396 (Iowa 2001) (citing *Dolan*, 431 N.W.2d at 794).

530. *Bellville*, 702 N.W.2d at 473.

531. *Id.*

532. *Id.* (quoting Gardner v. Hartford Ins. Accident & Indem. Co., 659 N.W.2d 198, 206 (Iowa 2003)) (internal quotation marks omitted).

bad faith.[533] Additionally, Iowa insurance statutes provide specifically that:

> All policies insuring the legal liability of the insured, issued in this state by any company, . . . shall . . . contain a provision providing that, in event an execution on a judgment against the insured be returned unsatisfied in an action by a person who is injured or whose property is damaged, the judgment creditor shall have a right of action against the insurer to the same extent that such insured could have enforced the insured's claim against such insurer had such insured paid such judgment.[534]

Therefore, this statute provides third parties a right of action directly against an insurer. However, the statute requires the third party to first obtain a judgment before an injured person may pursue a claim directly against the tortfeasor's insurer.[535] The Iowa Supreme Court regards the matter of permitting or not permitting an injured person to bring a direct suit against the tortfeasor's insurer as a matter of substantive law.[536] Consequently, Iowa provides for a cause of action in tort and contract, a detailed Unfair Claims Practices statute, as well as for a direct action by third parties against an insurer after certain conditions have been satisfied. Thus, Iowa is a "Brick" state.

Kentucky

Kentucky recognizes both a first-party action in tort and contract as well as claims under the Kentucky Unfair Claims Settlement Practices Act.[537] In *Wittmer v. State Farm Mutual Automobile Insurance Co.*, the Kentucky Supreme Court determined that a private cause of action of tortuous misconduct justifies a

---

533. IA. CODE ANN. § 507B.4(10) (West 2007 & Supp. 2011).

534. IA. CODE ANN. § 516.1 (West 2007).

535. *See* McCann v. Iowa Mut. Liab. Ins. Co., 1 N.W.2d 682, 689 (Iowa 1942).

536. *See* Eggermont v. Cent. Sur. & Ins. Corp., 17 N.W.2d 840, 843 (Iowa 1945).

537. KY. REV. STAT. ANN. § 304.12-230 (LexisNexis 2011).

claim for bad faith where the insured proves the following elements:

> (1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed.[538]

Additionally, Kentucky recognizes an injured person's rights to bring a claim against someone else's insurance company if the insurer refuses to negotiate fairly with the third party. This is known as "third party bad faith" under Kentucky law. In Kentucky, improper actions by insurers may also constitute a violation of the Kentucky Unfair Settlement Claims Practices Act ("KUCSPA").[539] The KUCSPA requires an insurance company "to deal in good faith with a claimant, whether an insured or a third-party, with respect to a claim which the insurance company is contractually obligated to pay."[540] The duties imposed by KUCSPA on an insurer to a third party apply both before and after the commencement of litigation.[541] In other words, under Kentucky law, the insurer must treat the insured, as well as the third-party claimant, with good faith and fair dealing at all times, including during negotiations. This includes any negotiations with the third-party claimant even after litigation has begun. Consequently, because Kentucky offers tort claims, as well as protections for third-party claimants, Kentucky is classified as a "Brick" state.

Louisiana

---

538. Wittmer v. State Farm Mut. Auto. Ins. Co., 864 S.W.2d 885, 890 (Ky. 1993) (quoting Fed. Kemper Ins. Co. v. Hornback, 711 S.W.2d 844, 846–47 (Ky. 1986) (Leibson, J., dissenting), *overruled by* Curry v. Fireman's Fund Ins. Co., 784 S.W.2d 176 (Ky. 1989)) (internal quotation marks omitted).

539. KY. REV. STAT. ANN. § 304.12-230.

540. Davidson v. Am. Freightways, Inc., 25 S.W.3d 94, 100 (Ky. 2000) (emphasis omitted); *see also* State Farm Mut. Auto. Ins. Co. v. Reeder, 763 S.W.2d 116, 118 (Ky. 1988) (holding third-party claims may be premised upon a violation of KUCSPA).

541. Knotts v. Zurich Ins. Co., 197 S.W.3d 512, 517 (Ky. 2006).

In the wake of Hurricanes Katrina and Rita, the Louisiana courts have had to deal with a rising number of bad faith claims.[542] Under Louisiana law, the types of recoverable damages resulting from a breach of contract, including insurance contracts, are governed by Louisiana's Civil Code.[543] An insured may seek first-party statutory penalties pursuant to statutory provisions, but the insured also has the burden of proving that the insurer had sufficient proof of loss, that the insurer failed to timely pay the claim, and that the failure was "arbitrary and capricious."[544] In *Vaughn v. Franklin*, the court discussed the difference between "bad faith" and "arbitrariness" holding that bad faith is more than simple negligence and that arbitrariness is a willful refusal not reasoned in good faith.[545]

Beyond the Civil Code provisions applicable to all contracts, Louisiana's Insurance Code allows for the recovery of damages, penalties, and attorney's fees from insurers under certain circumstances.[546] These statutory provisions are not uniform regarding the types of prohibited conduct that constitutes bad faith or the potential recovery for violation of the statutes. Also, Louisiana's statutory scheme applies different standards and penalties depending on the type of insurance involved in the action. While the Louisiana Unfair Trade Practices Act permits the imposition of certain penalties, that law does not create a private cause of action to recover those penalties.[547] Nevertheless, Louisiana allows rights of action for bad faith under other statutory provisions.[548]

---

542. *See, e.g.*, Pontchartrain Gardens, Inc. v. State Farm Gen. Ins. Co., No. 07-7965, 2009 WL 86671 (E.D. La. Jan. 13, 2009) (concerning the insurance claims and damages to an apartment building caused by Hurricane Katrina).

543. LA. REV. STAT. ANN. § 22:1973 (2009).

544. Boudreaux v. State Farm Mut. Auto. Ins. Co., 896 So.2d 230, 233 (La. Ct. App. 2005).

545. Vaughn v. Franklin, 785 So.2d 79, 86 (La. Ct. App. 2001) ("Arbitrariness is a more venial offense; it is a willful and unreasoning action, without consideration for the facts and circumstances presented, or acting with unfounded motivation.").

546. *See* LA. REV. STAT. ANN. § 22:1973.

547. *See* Theriot v. Midland Risk Ins. Co., 694 So. 2d 184, 189–93 (La. 1997); Alarcon v. Aetna Cas. & Sur. Co., 538 So. 2d 696, 700 (La. Ct. App. 1989).

548. *See, e.g.*, LA. REV. STAT. ANN. § 22:1973(B)(1)–(6) (listing bad faith actions).

In addition to the above, Louisiana qualifies as a "Brick" state based on several decisions, including *Pontchartrain Gardens, Inc. v. State Farm General Insurance Co.*, where the United States District Court for the Eastern District of Louisiana held that the insurer misapplied the burden of proof in finding for the insured in a bad faith action,[549] and *Theriot v. Midland Risk Insurance Co.*, where the Louisiana Supreme Court established that third-party claims for bad faith are allowed under the state's Unfair Claims Act.[550]

Louisiana is another difficult state to categorize. Bad faith in Louisiana is defined primarily by statutory provision, which includes some protections for third-party claimants, thus qualifying Louisiana as a "Brick" state similar to other states in this category that offer some avenue of redress for these claimants.

Michigan

Michigan is considered a "Brick" state for several reasons, including its attempt to clearly define an insurer's conduct that constitutes bad faith. In *Commercial Union Insurance Co. v. Liberty Mutual Insurance Co*., the Michigan Supreme Court stated that in order to prevail on a bad faith action, the insured must show conduct on the part of the insurer that is "arbitrary, reckless, indifferent, or intentional disregard of the interest of the person owed a duty."[551] Importantly, the court have further defined bad faith by listing specific factors, among them whether: (1) the insured was informed of developments that affected the insured's interest; (2) the insured was informed of settlement offers; (3) settlement offers or settlement negotiations were initiated when the circumstances called for such; (4) reasonable settlement offers were rejected, and (6) whether an appeal was taken when reasonable grounds for an appeal existed.[552] However, Michigan courts and federal courts applying Michigan law have long held that breach of an insurance contract, even if done in bad faith, does not give rise to a separate

549. Pontchartrain Gardens, Inc. v. State Farm Gen. Ins. Co., No. 07-7965, 2009 WL 86671 at *4–5 (E.D. La. Jan. 23, 2009).

550. *Theriot*, 694 So. 2d at 193.

551. Commercial Union Ins. Co. v. Liberty Mut. Ins. Co., 393 N.W.2d 161, 164 (Mich. 1986).

552. *Id.* at 165.

and independent tort claim.[553] Rather, some tortious conduct wholly independent of the contractual breach must be present.[554]

Specifically, in *Hayley v. Allstate Insurance Co*., the court noted that "[t]he failure to pay a contractual obligation or insurance benefits does not amount to outrageous conduct, even if it is done in bad faith or willfully. In a contractual setting, a tort claim must be based instead on the breach of a duty distinct from the contract." [555] Unlike most states, "Michigan law does not [generally] recognize an implied contractual duty of good faith."[556] In the insurance context, two exceptions to this rule have been recognized. Namely, an insurer has a contractual duty to exercise good faith when: (1) negotiating a settlement in third-party liability situations, and (2) investigating and paying claims.[557] Thus, a contract-based claim for breach of the implied covenant of good faith in investigating and paying an insurance claim is viable in Michigan.[558] Because Michigan recognizes a claim in contract, an inde-

---

553. *See, e.g.*, Cromer v. Safeco Ins. Co. of Am., No. 2:09-cv-13716, 2010 WL 1494469, at *3 (E.D. Mich. Apr. 14, 2010); Red Cedars, Inc. v. Westchester Fire Ins. Co., 686 F. Supp. 614, 615 (E.D. Mich. 1988); Kewin v. Mass. Mut. Life Ins. Co., 295 N.W.2d 50, 56 (Mich. 1980); Casey v. Auto Owners Ins. Co., 729 N.W.2d 277, 286–87 (Mich. Ct. App. 2006).

554. *See, e.g.*, Soc'y of St. Vincent De Paul v. Mt. Hawley Ins. Co., 49 F. Supp. 2d 1011, 1019 (E.D. Mich. 1999) (recognizing "that Michigan law does not recognize an independent tort based upon a bad faith breach of contract. Michigan law recognizes a tort claim only when a plaintiff's complaint alleges the breach of duties existing independent of and apart from the contract of insurance" (citations omitted) (internal quotation marks omitted)).

555. Hayley v. Allstate Ins. Co., 686 N.W.2d 273, 277 (Mich. Ct. App. 2004) (footnotes omitted).

556. Aetna Cas. & Sur. Co. v. Dow Chem. Co., 883 F. Supp. 1101, 1111 (E.D. Mich. 1995) (citing *Red Cedars*, 686 F. Supp. at 615–616; Dahlman v. Oakland Univ., 432 N.W.2d 304, 306 (Mich. Ct. App. 1988)).

557. *See, e.g.*, *Commercial Union*, 393 N.W.2d at 165 (Mich. 1986); City of Wakefield v. Globe Indem. Co., 225 N.W. 643, 644 (Mich. 1929).

558. *See, e.g.*, Burnside v. State Farm Fire & Cas. Co., 528 N.W.2d 749, 753 (Mich. Ct. App. 1995) (noting availability of penalty interest but not attorney's fees as damages for bad faith refusal to pay insurance claim); *see also Aetna*, 883 F. Supp. at 1111 ("Michigan case law regarding the contractual duty of good faith is limited in application. Courts have held only that an insurer has the duty to act in good faith in negotiating a settlement within the policy limits, and the duty to act in good faith in investigating and paying claims.").

pendent claim in tort, and clearly delineates actions that constitute bad faith, it qualifies as a "Brick" state.

Montana

Montana is considered a "Brick" state, as well. When an insurer acts in bad faith, Montana provides a right of action to the insured, the persons injured by the insured, and third parties under the Unfair Trade Practices Act ("UTPA").[559] Third parties are allowed to recover against another's insurance policy as it is the insurance company that usually controls the defense of the underlying lawsuit—and the decision to settle.[560] The UTPA provides a list of prohibited behavior, often referred to as "statutory bad faith,"[561] for which an insurance company will be liable to its policyholder, the injured third party, or both.[562]

However, in *Sampson v. National Farmers Union Property & Casualty Co.*, the Supreme Court of Montana held that "[t]he Legislature did not construct the UTPA to provide for the recovery of attorney fees and therefore we cannot construe it to do so."[563] Therefore, Montana statutes provide broad protections for both first-party and third-party claimants, but do include some limitations on damages. As for the availability of punitive damages, an insured can recover these damages by establishing that the insurer violated one or more specified subsections of the statute and by clear and convincing evidence that the insurer acted with actual malice or actual fraud.[564] Due to the protections for first and third parties, Montana is a "Brick" state.

---

559. MONT. CODE ANN. § 33-18-242(1) (2011).

560. *See generally* Brewington v. Emp'rs Fire Ins. Co., 992 P.2d 237 (Mont. 1999) (holding that Montana recognizes a third-party cause of action against an insurer).

561. *See* Carlson v. State Farm Mut. Auto. Ins. Co., No. BDV-00-140(c), 2005 Mont. Dist. LEXIS 1715 (Mont. Dist. Dec. 19, 2005) (using the phrase "statutory bad faith" to refer to claims under MONT. CODE ANN. § 33-18-242(1)).

562. MONT. CODE ANN. § 33-18-242(1).

563. Sampson v. Nat'l Farmers Union Prop. & Cas. Co., 144 P.3d 797, 802 (Mont. 2006).

564. *See* Dees v. Am. Nat'l. Fire Ins. Co., 861 P.2d 141, 149–50 (Mont. 1993).

Washington

In Washington, the Supreme Court of Washington outlined the considerations for allowing bad faith actions in 2008.[565] For example, in *St. Paul Fire & Marine Insurance Co. v. Onvia*, *Inc.*, the insurer filed a declaratory judgment action against the insured for a determination that it had no duty to defend the insured in a class action.[566] The insured filed counterclaims including breach of the contractual duties to defend, indemnify, and settle; bad faith for breach of these duties; procedural bad faith; and violation of the Consumer Protection Act of Washington.[567] The trial court granted summary judgment on the first two claims.[568] The court held that under Washington law, bad faith is grounded in tort and not contract.[569] The court concluded that an insured could pursue common law bad faith and a violation of the Consumer Protection Act based solely on "procedural missteps" in handling the claim by the insurer, even though the insurer may have no contractual duty to defend, settle, or indemnify the insured.[570]

More recently, the Washington Court of Appeals clarified the decision in *St. Paul Fire & Marine.* In *Moratti ex rel. Tarutis v. Farmers Insurance Co. of Washington*, the court restated that a bad faith claim against an insurer under state law is rooted in tort, and thus subject to a three-year tort statute of limitations.[571] To show bad faith, the insured must prove that the insurer's conduct was "unreasonable, frivolous, or unfounded."[572] "An insurer owes its insured a duty to act in good faith, which includes an affirmative duty to undertake a good faith effort to settle when an in-

565. St. Paul Fire & Marine Ins. Co. v. Onvia, Inc., 196 P.3d 664 (Wash. 2008).

566. *Id.* at 666.

567. *Id.* at 666–67; *see* WASH. REV. CODE ANN. §§ 48.30.010–.900 (West 2010 & Supp. 2012).

568. *St. Paul Fire & Marine*, 196 P.3d at 667.

569. *Id.* at 668 (citing Safeco Ins. Co. v. Butler, 823 P.2d 499, 503 (Wash. 1992)).

570. *Id.* at 669.

571. Moratti *ex rel.* Tarutis v. Farmers Ins. Co., 254 P.3d 939, 942–43 (Wash. Ct. App. 2011) (applying the same principles as any other tort: duty, breach of that duty, and damages proximately caused by the breach).

572. *Id.* at 944.

sured's liability is likely."[573] Specifically in the case, Farmer's Insurance argued that there was no presumption of harm because the insured was claiming it had mishandled the claim—which differs from the duty to defend, settle, or indemnify—and thus, the insured had to show actual harm.[574] The insurer further contended, under *St. Paul Fire & Marine*, that the insured could not bring his action because no settlement or demand was offered to the insurer.[575] The court found that the insurer "ignore[d] the principle that the duty to settle is intricately and intimately bound up with the duty to defend and to indemnify."[576] That duty is ongoing and did not end "merely because the insurer offer[ed] the policy limits two years after it left the insured with the belief that there was no liability."[577] The court concluded that once the insured met the burden of establishing bad faith, a rebuttable presumption of harm followed.[578] Further, the court held that this burden was appropriate because the insurer controls its actions—in good faith or bad—so it must show that its conduct was not in bad faith.[579] As a result, the court reinstated the jury verdict for the insured.[580]

Similar to other "Brick" states, Washington provides some protections for third-party claimants. The duty of good faith is applicable to both first-party and third-party coverage.[581] Additionally in the third-party context, an insurer can act in bad faith even where coverage is later determined to be unavailable.[582] Washington qualifies as a "Brick" state in that it provides for common law

573. *Id.* at 942.
574. *Id.* at 943.
575. *Id.*
576. *Id.*
577. *Id.*
578. *Id.* at 947.
579. *Id.* at 945.
580. *Id.* at 947.
581. *See, e.g.*, Mut. of Enumclaw Ins. Co. v. Dan Paulson Constr., Inc., 169 P.3d 1 (Wash. 2007) (holding that sending subpoena and engaging in ex parte communication constituted bad faith in third-party case); Coventry Assocs. v. Am. States Ins. Co., 961 P.2d 933 (Wash. 1998) (finding that failure to investigate first-party claim was in bad faith).
582. *See, e.g.*, Kirk v. Mt. Airy Ins. Co., 951 P.2d 1124, 1131 (Wash. 1998) (finding refusal to defend third-party claim in bad faith actionable even though insured's claim was not covered); Safeco Ins. Co. v. Butler, 823 P.2d 499, 512 (Wash. 1992) (holding insurer's delays constituted bad faith in third-party reservation of rights defense even though insured was not covered).

bad faith claims as well as the right of the first party to pursue actions under the Consumer Protection Act, and appears to permit the third-party claimant to bring an action against the insurer.

West Virginia

West Virginia clearly defines bad faith as:

> wherever there is a failure on the part of an insurer to settle within policy limits where there exists the opportunity to so settle and where such settlement within policy limits would release the insured from any and all personal liability, that the insurer has prima facie failed to act in its insured's best interest and that such failure to so settle prima facie constitutes bad faith towards its insured.[583]

However, recent actions in West Virginia indicate that the state is wrestling with whether third-party claimants have standing to bring a direct bad faith action against an insurer.[584] In 2010, in *Michael v. Appalachian Heating, LLC*, the West Virginia Supreme Court of Appeals announced that third-party claimants once again have, in at least some situations, a private cause of action for bad faith insurance claim handling.[585] Since 2005, such claims in West Virginia have been statutorily confined to administrative proceedings.[586] In *Michael*, the plaintiffs were African-Americans who lived in public housing whose personal property was destroyed in an apartment fire.[587] The cause of the fire was alleged to have been improper work done by Appalachian Heating, which State Auto insured.[588] According to the complaint, State Auto improperly considered the plaintiffs' race and residence in public housing while

583. Shamblin v. Nationwide Mut. Ins. Co., 396 S.E.2d 766, 776 (W. Va. 1990).

584. *See, e.g.*, Michael *ex rel.* Michael v. Appalachian Heating, LLC, 701 S.E.2d 116, 125 (W. Va. 2010) (noting that while the Unfair Trade Practices Act precludes a third-party action, the same claim is not precluded under the Human Rights Act).

585. *Id.* at 125–26.

586. W. VA. CODE ANN. § 33-11-4a (LexisNexis 2011).

587. *Michael*, 701 S.E. 2d at 118.

588. *Id.*

evaluating, processing, and adjusting plaintiffs' claims and while compensating them for the same.[589] The *Michael* court "reject[ed] State Auto's argument that, because the UTPA precludes a third-party action against an insurer, the Plaintiffs' sole remedy is to file an administrative complaint with the Insurance Commissioner pursuant to the UTPA."[590] Despite no more specific allegations in the case, the court re-opened the door to *limited* third-party claims as a private cause of action under the circumstances, where these plaintiffs' allegations were based on the insurer's disparate treatment because of their race.[591] The court deemed these circumstances to fall squarely within the state's Human Rights Act and not under the UTPA, circumventing the UTPA's prohibition of a third-party law suit against an insurer.[592] Thus, West Virginia law permits third parties to bring claims directly under some state provisions, but continues to recognize a prohibition against third parties bringing claims under its UTPA. For the foregoing reasons, West Virginia is considered a "Brick" state.

D. Other

Some states do not fit into the analogy at all. In this "other" category, these are states that simply have unsettled law with regard to bad faith. While some of the previously categorized states could fit into the "other" category, New Hampshire is the most representative. For example, in *Jarvis v. Prudential Insurance Co.*, the Supreme Court of New Hampshire held the insurer's wrongful or bad faith refusal to settle or pay a claim pursuant to its contractual obligation did not give rise to a cause of action in tort, where the insureds filed an action against the insurer for its failure to pay medical benefits under a health insurance policy.[593] The court determined that the amended pleadings by the insureds did not state a cause of action in tort against the insurer and that the cause of action for bad faith breach of contract could not be determined, as it depended on the outcome of their pending declaratory judgment action.[594]

---

589. *Id.* at 119.
590. *Id.* at 125 (citing W. VA. CODE ANN. § 33-11-4a(a)).
591. *See id.* at 125–26.
592. *Id.* at 125; *see* W. VA. CODE ANN. § 5-11-9 (LexisNexis 2011).
593. Jarvis v. Prudential Ins. Co., 448 A.2d 407, 408 (N.H. 1982).
594. *Id.* at 410–11.

In *Lawton v. Great Southwest Fire Insurance Co*., however, the New Hampshire Supreme Court specifically stated that, while it was aware "of an emerging trend in other jurisdictions to hold insurers liable in tort for the wrongful refusal or delay to make payments due under an insurance contract," it did not agree, and stated that a breach of contract *alone* does not give rise to a tort action.[595] Importantly, the *Lawton* court went on to hold that "if, however, the facts constituting the breach of the contract also constitute a breach of a duty owed by the defendant to the plaintiff independent of the contract, a separate claim for tort will lie."[596] Therefore, New Hampshire law has rejected the tort of bad faith for first-party claimants on a breach of contract claim, but recognizes a tort if the insurer owes the insured a duty independent of the contract.

Additionally, New Hampshire has adopted an Unfair Insurance Trade Practices Act,[597] which seemingly grants avenues of recovery to "any consumer claiming to be adversely affected," which would appear to include first- and third-party claimants.[598] Specifically, the statute provides:

> When a supplier, in any action or proceeding brought by the insurance commissioner, has been found to be in violation of this chapter or has been ordered to cease and desist, and said finding or order has become final, any consumer claiming to be adversely affected by the act or practice giving rise to such finding or order may bring suit against said supplier to recover any damages or loss suffered because of such action or practice.[599]

So, whereas New Hampshire has refused to extend a cause of action in tort for bad faith to first-party cases—except in situations where an independent duty is owed—it does provide statutory pro-

595. Lawton v. Great Sw. Fire Ins. Co., 392 A.2d 576, 580 (N.H. 1978).
596. *Id.*
597. N.H. REV. STAT. ANN. §§ 417:1–417:31 (LexisNexis 2009 & Supp. 2011).
598. N.H. REV. STAT. ANN § 417:19(I).
599. *Id.*

tections and has expanded damages available under breach of contract claims.

Finally, regarding punitive damages in New Hampshire, the insured's damages are not limited as a matter of law to only the damages available for a breach of the insurance contract or the policy amounts. However, because the *Lawton* court did not recognize an independent action for tort for the insurer's wrongful refusal or delay to settle a first-party insurance claim, it would appear that traditional tort damages such as punitive damages would not be available to the insured.[600] Thus, in this difficult to define category of "Other," New Hampshire's conflicting decisions represent a state where a claimant must navigate the case law and statutory provisions to determine what avenues are available to redress claims of unfair or improper claims practices.

V. MODEL RULES

What is evident from the state-by-state analysis of how bad faith is defined and applied is that there are a myriad of ways in which bad faith claims exist. Bad faith is sometimes rooted in contract, sometimes rooted in tort, and sometimes sounds in both. It may be brought exclusively as a common law claim, a contract claim, or both; or it may be brought in addition to or simply as a violation of a statutory provision. Adding to this uncertainty is that there is no simple, clear definition of what constitutes bad faith by which insurers can shape their claim handling practices. Additionally, insureds have no clear standards by which to measure the actions or inactions of insurers in the treatment of their claims. Most particularly, there is a lack of precision regarding timelines for the adjusting and handling of claims for both insurers and insureds. This confusion and lack of clarity as to what constitutes bad faith results in inconsistent decisions, conflicting laws, uncertainty, and increased litigation. As a result, there appears to be a need to unambiguously define what constitutes improper claims practices or bad faith.

The National Association of Insurance Commissioners ("NAIC") has promulgated model regulations regarding unfair trade and settlement practices in several areas of insurance that

600. *Lawton*, 392 A.2d at 580–81.

may help to define what actions or inactions could give rise to a bad faith claim.[601] Generally, these provisions address and define conduct by insurers that amounts to unfair claims practices.[602] Specifically, these include such actions as a misrepresentation of policy provisions, failures to adequately and timely investigate claims, and lack of policy provisions regarding settlement practices.[603] Further, the Model Rules include such specific timeframes as:

> A. Within twenty-one (21) days after receipt by the insurer of properly executed proofs of loss, the first[-]party claimant shall be advised of the acceptance or denial of the claim by the insurer. . . . B. If the insurer needs more time to determine whether a first[-]party claim should be accepted or denied, it shall so notify the first party claimant within twenty-one (21) days after receipt of the proofs of loss, giving the reasons more time is needed. If the investigation remains incomplete, the insurer shall, forty-five (45) days from the initial notification and every forty-five (45) days thereafter, send to the claimant a letter setting forth the reasons additional time is needed for investigation. . . . F. The insurer shall affirm or deny liability on claims within a reasonable time and shall tender payment within thirty (30) days of affirmation of liability, if the amount of the claim is determined and not in dispute. . . .[604]

While many of these same standards are found to be incorporated in individual states' Unfair Trade Practice Acts, most states do not permit a private right of action under their statutes.

The Model Regulations also provide additional instruction and clarification by including detailed timeframes by which insurers should respond, investigate, and pay appropriate claims. While exceptions exist depending on circumstances surrounding claims,

---

601. NAIC UNFAIR CLAIMS SETTLEMENT PRACTICES ACT 900-1 (2011).

602. *Id.*

603. *Id.* 900-2 § 4.

604. NAIC UNFAIR PROP./CAS. CLAIMS SETTLEMENT PRACTICES MODEL REGULATION 902-4 § 7 (2011).

the suggested timeframes provide clarification to both sides once a claim is made. These model rules are perhaps the clearest and most easily applied standards regarding the conduct of insurers towards insureds and third-party claimants. As such, it is instructive to review how states treat these model rules and to what extent, if any, they have been adopted by the states, in order to provide a thorough analysis of each state's treatment of bad faith actions and improper claims practices.

As this Article shows, states such as Hawaii, South Carolina, and Massachusetts have protections for first-party claims, including actions in both tort and contract, yet they have not adopted the Model Rules or related provisions.[605] Conversely, other states, such as Georgia, Illinois, and Tennessee, have taken steps to adopt in full or in part the provisions of the Model Rules and enact "related activity," yet those actions do not result in broad protections for insureds or third parties.[606] This contradiction is at the heart of the confusion regarding how and when bad faith occurs and a lack of uniform and consistent rules regarding bad faith. In conclusion, a simple definition of what actions constitute bad faith is elusive. However, the Model Code definitions and provisions, particularly with regard to appropriate timeframes, seem to be the most clear and definitive. Therefore, if the Model Code provisions were adopted uniformly in states, insurers and insureds would know exactly what actions would and would not give rise to bad faith actions, while still allowing states to implement their individual treatment of third-party claimants and the viability of punitive damages.

VI. PREVENTING HUFFING AND PUFFING IN VAIN: LESSONS FOR THE BIG, BAD WOLF, OR HOW TO AVOID A BAD FAITH CLAIM

Once it is established *what* constitutes bad faith, it is important to consider how to avoid a bad faith claim. While not pur-

---

605. *See supra* text accompanying notes 271–76, 292–98, and 417–25.

606. *See* TENN. CODE ANN. §§ 47-18-101 to -502 (2001 & Supp. 2011), § 56-7-105 (2008), §§ 56-8-101 to -306 (2008 & Supp. 2011); GA. COMP. R. & REGS. 120-2-52-.01 to -.09 (2012), *available at* http://rules.sos.state.ga.us/cgi-bin/page.cgi?g=COMPTROLLER_GENERAL%2Findex.html&d=1; ILL. ADMIN. CODE tit. 50, §§ 919.10–919.100 (2011), *available at* http://www.ilga.gov/commission/jcar/admincode/050/05000919 sections.html.

porting to provide an exhaustive catalogue of situations necessarily giving rise to a bad faith claim, this Part includes several easily identifiable areas of risk.

A. Relay Settlement Demands

One of the simplest means for an insurer's attorney to establish negligence on the part of the insurer, and thereby set up a potential claim for bad faith, is to identify the failure of the insurer to communicate with the insured. Whenever a settlement demand is made, the demand should be forwarded and reviewed by the insured. The importance of maintaining open lines of communication with the insured cannot be overstated. When there has been appropriate communication, the settlement offer is more likely to be acceptable, avoiding an excess verdict and a claim for bad faith.

B. Appropriately and Timely Respond to All Demand Letters

Counsel for the insurer must appropriately and timely respond to a demand letter, which is an important element in some states for the establishment of a claim.[607] While a response itself is important, the insurer's counsel must ensure it is both sufficiently prompt and specific. Oftentimes, the injured third party's attorney is motivated to send the demand letter for settlement within the policy limits early in the case in order to establish the elements for excess liability, as well as to possibly set up a claim of bad faith. One may avoid this situation by including in the response any additional information or investigation that is needed, including information from the third party asserting the claim, before the insurer can appropriately respond to the demand.

C. Be Cognizant of a "Limits Demand"

The insurer and the insured must be aware of a "limits demand," i.e., a demand for settlement *up to* the limits of the coverage.[608] For a plaintiff's attorney, it is important to assert a limits demand for several reasons. One consideration in making this demand is protection from a possible malpractice claim by the client for demanding "too little." By demanding the "limits," an attorney cannot be accused of demanding an amount insufficient to fully compensate the client. Additionally, a demand for settlement with-

---

607. In South Carolina, for example, the response to a demand letter is required under the *Tyger River* doctrine. *See* Kefalos, *supra* note 79, at 21–22.

608. *See* Kefalos, *supra* note79, at 21–22.

in or at the policy limits is an element to establishing payment by the insurer under the excess liability doctrine, as well as a claim of bad faith.[609] Therefore, it is important that plaintiff's counsel convey a demand to settle within the limits of the policy. Conversely, a limits demand requires some type of response from the insurer's counsel, which again should be specific, as outlined above.

D. Paper the File

It is important for both the plaintiff's counsel—whether representing a third party or the insured—and the insurer's counsel to document the file. If a claim of bad faith arises, it is certain the file will become discoverable in order to ascertain the attorney's actions. For the plaintiff's counsel, it is imperative that the attorney conveyed a "limits demand" offering to settle within the limits of the policy accompanied by a time demand. It is equally important that the defense counsel document his or her file, noting what was communicated to the insured and when, how the insured responded, and how the adjuster responded.

E. Timely Recognize Cases with Potential Excess Liability Exposure

One may potentially avoid a subsequent claim of bad faith by timely recognizing cases carrying potential excess liability exposure. Often characterized by third-party claimants suffering significant injuries or catastrophic losses, these cases routinely include wrongful death cases, particularly in cases with minimum limits of coverage. The exposure for the insured to a judgment in excess of the policy limits is often central to a potential claim of bad faith; the greater the disparity between the excess and the limits, the greater the chance of a successful claim for bad faith.

F. Identify "Clear Liability" Cases

Attorneys must recognize "clear liability" cases, such as where the damages are generally the only issue. An example of such a case might arise where the insurer has accepted some form of liability such as paying property damage, and the only remaining argument is the issue of compensable damages. Perhaps it is this category of cases that tends to create the greatest risk or success for a claim of bad faith.

---

609. *See id.*

Many state legislatures have adopted statutory provisions outlining specific elements that constitute improper claims practices. These statutes specifically identify practices as improper if committed with just cause and performed with such frequency as to indicate a general business practice.

Examples of provisions from such a statute include:

> 1) Knowingly misrepresenting to insured or third-party claimants pertinent facts or policy provisions relating to coverages at issue or providing deceptive or misleading information with respect to coverages.
>
> 2) Failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies, including third-party claims arising under liability insurance policies.
>
> 3) Failing to adopt and implement reasonable standards for the prompt investigation and settlement of claims, including third-party liability claims, arising under its policies.
>
> 4) Not attempting in good faith to effect prompt, fair, and equitable settlement of claims, including third-party claims, submitted to it in which liability has become reasonably clear.
>
> 5) Compelling policyholders or claimants, including third-party claimants under liability policies, to institute suits to recover amounts reasonably due or payable with respect to claims arising under its policies by offering substantially less than the amounts ultimately recovered through suits brought by the claimants or through settlements with their attorneys employed as the result of the inability of the claimants to effect reasonably settlements with the insurers.
>
> 6) Offering to settle claims, including third-party claims, for an amount less than the amount other-

> wise reasonably due or payable based upon the possibility or probability that the policyholder or claimant would be required to incur attorney's fees to recover the amount reasonably due or payable;
>
> 7) Invoking or threatening to invoke policy defenses or to rescind the policy as of its inception, not in good faith and with a reasonable expectation of prevailing with respect to the policy defense or attempted rescission, but for the primary purpose of discouraging or reducing a claim, including a third-party liability claim. [And/or]
>
> 8) Any other practice which constitutes an unreasonable delay in paying or an unreasonable failure to pay or settle in full claims, including third-party liability claims arising under coverages provided by its policies.[610]

It is important to note that while the actions representing improper practices are clearly defined by the statute, as stated above, many such statutes do not provide for a private right of action for insureds or third parties for statutory violations. Rather, Departments of Insurance or other state administrative agencies are vested with determining whether an insurer has violated the insurance code.[611]

VII. CONCLUSION

Bad faith litigation continues to grow, and courts are faced with the question of defining what constitutes an insurer's obligation to not act in bad faith. Although all courts agree that an insurer owes some duty in this respect, courts wrestle with what constitutes that duty, or a breach thereof. State legislatures have circumscribed those duties to some extent, but questions remain. As the concept evolves, it is important to understand ways in which bad faith will be characterized and delineated. It is also important for practitioners on both sides to understand how bad faith is applied and the areas that create the greatest risk of a bad faith claim. This

610. S.C. CODE ANN. § 38-59-20 (2002).

611. *See* Masterclean, Inc. v. Star Ins. Co., 556 S.E.2d 371 (S.C. 2001).

can only be done by understanding the treatment of bad faith in the jurisdictions in which they practice. Exploring these matters in detail will hopefully provide tools to assist insureds, insurers, and practitioners as they navigate this evolving area of law.