BAD FAITH CLAIMS AGAINST INSURERS*

New York jurisprudence is clear that liability insurers owe their insureds the duty of good faith and fair dealing to act in their insureds best interests in defending and settling claims. This duty arises as implied covenants of the contract between the insurer and insured and includes the duty of thorough investigation of all claims and defenses that may be asserted for or against the insured. New York law does not generally recognize a tort action based on insurer bad faith. However, where the insurer fails to settle an action within the policy limits resulting in a judgement against the insured for a sum in excess of the policy limits the insured may bring a direct action against the insurer for bad faith to recover the excess judgement above the policy limits. This is premised on the fact that the insurer has complete control over all claims handling and defenses asserted on behalf of the insured during the litigation proceedings. This right of action may be assigned by the insured defendant to the injured plaintiff allowing a direct action against the insurer for bad faith refusal to settle and if proven the injured party may recover the excess judgement above the policy limits from the insurer.

The Court of Appeals, in the seminal case of **Pavia v. State Farm Mut. Auto. Ins. Co., 82 N.Y.2nd 445 (1993),** set forth the following requisites in order for plaintiff to make out a prima facie case of bad faith for refusal to settle:

> "Faced squarely with the question for the first time, we reject defendant's proposed requirement of a "sinister motive" on the part of the insurer (see, Cappano v Phoenix Assur. Co., 28 AD2d 639, 640), and hold instead that, in order to establish prima facie case of bad faith, the plaintiff must establish that the insurer's conduct constituted a "gross disregard" of the insured's interests--that is, a deliberate or reckless failure to place on equal footing the interests of its insured with its own interests when considering

a settlement offer (see, Lozier v Auto Owners Ins. Co., 951 F2d 251 [9th Cir]). In other words, a bad-faith plaintiff must establish that the defendant insurer engaged in a pattern of behavior evincing a conscious or knowing indifference to the probability that an insured would be held personally accountable for a large judgment if a settlement offer within the policy limits were not accepted."

Further, proof of the insurers ordinary negligence will not suffice. The Court in **Pavia, supra,** further elaborates additional factors for the trier of facts to consider:

"Naturally, proof that a demand for settlement was made is a prerequisite to a bad-faith action for failure to settle (United States Fid. & Guar. Co. v Copfer, 48 NY2d 871, 873). However, evidence that a settlement offer was made and not accepted is not dispositive of the insurer's bad faith. It is settled that an insurer "cannot be compelled to concede liability and settle a questionable claim" (St. Paul, supra, at 978) simply "because an opportunity to do so is presented" (Knobloch v Royal Globe Ins. Co., 38 NY2d 471, 479). Rather, the plaintiff in a bad-faith action must show that "the insured lost an actual opportunity to settle the … claim" (Copfer, supra, at 873) at a time

when all serious doubts about the insured's liability removed (St. Paul, supra at 978; DiBlasi, supra at 98-99). “

“Bad faith is established only "where the liability is clear and the potential recovery far exceeds the insurance coverage" (DiBlasi, supra, at 98). However, it does not follow that whenever an injury is severe and the policy limits are significantly lower than a potential recovery the insurer is obliged to accept a settlement offer. The bad-faith equation must include consideration of all of the facts and circumstances relating to whether the insurer's investigatory efforts prevented it from making an informed evaluation of the risks of refusing settlement. In making this determination, courts must assess the plaintiff's likelihood of success on the liability issue in the underlying action, the potential magnitude of damages and the financial burden each party may be exposed to as a result of a refusal to settle. Additional considerations include the insurer's failure to properly investigate the claim and any potential defenses thereto, the information available to the insurer at the time the demand for settlement is made, and any other evidence which tends to establish or negate the insurer's bad faith

in refusing to settle. The insured's fault in delaying or ceasing settlement negotiations by misrepresenting the facts also factors into the analysis (see, Lozier v Auto Owners Ins. Co., 951 F2d 251, 254 [9th Cir 1991], supra; see also, 14 Couch, Insurance 2d § 51:137 "

In **Pavia, supra,** the Court of Appeals reversed the Appellate Division's affirmance of the trial court's entry of a judgement of $4,688,030 based on jury's verdict finding bad faith against State Farm. The Court concluded the injured plaintiff (assignee of defendant's cause of action) did not prove bad faith based on the insurer's failure to respond to plaintiff's limited time (30 day) pretrial settlement demand to pay the 100K policy limits at a time when the insurer was still investigating the claim based on defendant's recent EBT testimony. Said testimony raised other potential defenses involving the actions of the other parked vehicle backing up confronting defendant with an emergency and including plaintiff passenger not wearing a seat belt and alleged drug use. Six months later after further investigation did not prove fruitful and at a "settle or select conference "State Farm offered the policy limits which was rejected by the plaintiff as untimely and the case proceeded to trial resulting in substantial excess verdict above the 100K policy limits. The fact that State Farm initially evaluated the liability issue against its insured and could have acted in a timelier manner or could have requested additional time to respond to the pre-trial settlement demand six months before trial was not germane to the court's analysis as delay alone may be considered ordinary negligence not sufficient to prove bad faith.

New York Pattern Jury Instruction **4:67** provides that, in determining whether an insurer has acted in bad faith in refusing to settle a claim on behalf of its insured, the jury may consider a number of factors including "whether the insurer had informed the insured of the amount for which the opposing party was prepared to settle his claim and the negotiations with the opposing party ". This charge was upheld by the Court of Appeals in the leading case of **Smith v. General Accident Ins. Co., 91 N.Y. 2nd 648 (1998)** reversing the decision of the Appellate Division and reinstating the judgement based on jury verdict finding bad faith against insurer and awarding injured plaintiff substantial

damages above the policy limits. Once again, the injured plaintiff had obtained a proper assignment of defendant insured's rights under the policy in order to bring a bad faith action against the insurer.

The Court stated that although there is no legal duty for insurer to disclose settlement offer and negotiations to insured, evidence of industry custom and practice is universal in requiring such disclosure as well as the insurer's particular practice in question was to disclose settlement offer in circumstances where the insured is personally exposed to an excess verdict above the policy coverage limits. Therefore, such evidence is admissible to show bad faith but alone is not sufficient to make out a prima facie case of bad faith. The court relied on the covenant of good faith and fair dealing implied in all liability insurance contracts as insurer has complete control over the claims process and settlement while acting on behalf of its insured. An inherent conflict of interest arises between the insurer and insured when the policy limits are at risk. The insurer cannot evaluate its financial burden of risking loss of the policy limits alone without considering the financial burden and risk to the insured of an excess verdict and potential financial ruin. In other words, the insurer must place the interests of the insured on equal footing with its own interests when considering a settlement offer.

The failure of insurer to disclose a settlement offer and negotiations to insured under circumstances where insured is exposed to verdict in excess of the policy limits is one of many factors that may be considered by the jury under **PJI 4:67.** For an excellent discussion of these factors see J. Arthur M. Schack's 24-page decision granting summary judgement to injured plaintiff on his bad faith claim against insurer in **Taveras v. American Tr. Ins. Co., 33 Misc. 3d 1210 (2011).** J. Schack identified the following factors set forth in the charge which he found were proven by plaintiff and based on the uncontroverted evidence presented an outrageous example of bad faith on the part of American Transit:

1. The probability, in light of the evidence that would be presented to the jury by plaintiff and defendant at trial, that the jury would find in favor of

plaintiff and a verdict would be in excess of the policy. (Knobloch v Royal Globe Ins, Co., 38 NY2d 471, 344 N.E.2d 364, 381 N.Y.S.2d 433 [1976]).

2. Whether the insured lost an actual opportunity to settle the claim at a time when all serious doubts about the insured's liability were removed. (Pavia, supra; St. Paul Fire & Marine Ins. Co. v United States Fid. & Guar. Co., 43 NY2d 977, 375 N.E.2d 733, 404 N.Y.S.2d 552 [1978]).

3. Whether the insurer's investigatory efforts prevented it from making an informed evaluation of the risks of refusing settlement and probability of a verdict against the insured. (Pavia, supra; Gordon v Nationwide, supra).

4. What if any attempts were made by insurer to settle plaintiff's claim and at what point during the underlying action those attempts were made. (Knobloch, supra; Doherty v. Merchants Mut. Ins. Co., 74 A.D.3d 1870, 903 N.Y.S.2d 836 [4d Dept 2010]; State v Merchants Ins. Co., 109 AD2d 935, 486 N.Y.S.2d 412 [3d Dept 1985]).

5. Whether insurer informed insured of: an amount plaintiff was willing to settle for; the possibility of being exposed to any excess verdict for plaintiff; and, any negotiations conducted between plaintiff and the insurer. (Smith v Gen. Acc. Ins. Co., 91 NY2d 648, 697 N.E.2d 168, 674 N.Y.S.2d 267 [1998]).

6. Relative financial risk involved for insured if the settlement was not made compared with the risk to defendant insurer, in terms of the policy limit, if the settlement was not made. (Pavia, supra; Vecchione v. Amica Mut. Ins. Co., 274 A.D.2d 576, 711 N.Y.S.2d 186 [2d Dept 2000]; Brockstein v Nationwide Mut. Ins. Co., 417 [****8] F2d 703 [2d Cir 1969]; Brown v U.S. Fidelity & Guaranty Co., 314 F.2d 675 [2d Cir 1963]).

7. Whether any other evidence tends to establish or negate the insurer's bad faith in refusing to settle. (Smith v Gen. Acc., supra; Pavia, supra).

A fascinating medical malpractice case discussing the above principals and rules in the context of bad faith claims for failure to settle within the policy limits is the Third Department's decision in **Healthcare Professionals**

Inc. v. Parentis, 165 A.D.3d 1558 (3rd Dept. 2018). Following unsuccessful appeal affirming the 8.6 million Plaintiff's verdict in the underlying medical malpractice action against Parentis, which exceeded defendants' 2.3 million combined policy limits, the excess carrier **HPI** brought a declaratory judgement action against the primary carrier **Medical Liability Mutual Insurance Company, defendant Parentis and injured Plaintiffs** seeking a declaration that it acted in good faith and fair dealing during the settlement negotiations in the underlying action. Defendant Parentis and injured plaintiffs brought cross claims and counterclaims alleging bad faith on the part of both insurers in failing to communicate settlement demand and settle the action within the available policy limits at a time when all serious doubt of liability was removed causing defendant lost opportunity for settlement.

The Third Department reversed summary judgement for both insurers finding questions of fact existed regarding bad faith conduct of both insurers during the litigation and particularly during jury deliberations in the case. The court noted that the injured plaintiff made pretrial settlement demands against the defendant Parentis for the policy limits of 2.3 million with no offer of settlement forthcoming. It was clear from the outset that the injuries and potential damages including above the knee amputation resulting from treatment of ankle fracture exceeded the policy limits. However, defendant was not advised of the settlement demand before jury deliberations began and liability was sharply disputed in the underlying trial as the defendant presented expert testimony from an orthopedic expert which could have resulted in a defense verdict.

The key time frame arises during jury deliberations over a 1 hour and 20-minute period after the jury returned a note at 2:24pm asking for a read back on the life care planner's expert's testimony of 1.1 million in special damages. After the readback at 2:56pm defense counsel advised the defendant to settle for the policy limits and his consent to settle was promptly obtained. Defense counsel confirmed that plaintiff was still willing to settle for the 2.3 million policy limits. Between 2:56pm and the jury's verdict taken at 3:44pm there were several conversations between the claims department representatives for both insurers the substance of which were in dispute. MLMIC claimed they obtained consent to tender the 1.3 million primary policy but HPI refused to tender the 1 million excess policy. HPI claimed they were not informed MLMIC

had agreed to tender its policy and therefore HPI as excess carrier could not tender its policy limits. The court reasoned that the disputed conversations raised credibility issues and triable issues of fact concerning bad faith requiring denial of summary judgement. Moreover, the court rejected the insurers' argument limited to proximate cause that there was insufficient time to allow them to deliberate and tender both policies and therefore defendant did not lose an opportunity to settle the claim at a time when all serious doubt about liability was removed.

The concurring opinion agreed with the majority's decision denying summary judgement but would have limited the bad faith argument to just the short time frame from the jury note until the verdict was rendered. Practically speaking without the jury's note requesting read back of testimony on the life care plan it does not appear that bad faith could be proven as the defendant's liability was still in doubt.

CONCLUSION

It is readily apparent that proving bad faith against insurer for failure to settle within the policy limits is very difficult especially in medical malpractice cases where there are usually opposing experts for each side raising questions about the defendant's liability. In bifurcated personal injury actions, there is more opportunity to establish bad faith after the jury has already established liability of the insured. In all personal injury cases there must be prima facie evidence showing no serious doubt of the defendant's liability due to ongoing investigations at a time when the insured was deprived of the opportunity to settle the case within the policy limits thereby exposing insured to personal liability and financial ruin for a likely verdict far in excess of the policy limits. Moreover, as a prerequisite to bringing a bad faith action the injured party must first obtain an assignment of rights from the insured who suffered the excess verdict. The injured party must carefully document all settlement demands and offers before and during trial with defense counsel and /or insurers putting them on notice of bad faith and the opportunity to settle within the applicable policy limits or suffer the consequences of accountability for an excess verdict. The demand letters should address the standards and factors raised in **Pavia, supra.** and **Smith, supra.,** submitting evidence of clear liability and injuries and damages that far exceed the policy limits. Although this is a tough road to

navigate, in many cases the injured party can raise bad faith arguments supported by evidence to help facilitate settlement within policy limits without the need for a jury verdict.

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