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Ethical Considerations & Strategies for Claims Professionals to Avoid Bad Faith Claims

July 29, 2015 – Chicago

Origin of Bad Faith Claims

- Courts enforce an implicit duty of good faith and fair dealing in every insurance contract.

- The causes of action available for bad faith claims against insurance adjusters vary *widely* by state.

- Damages for bad faith claims are based on the wealth of the provider. With claims on the rise, it is particularly important to know the law in your state.

Sources of Law

- Common Law
- Statute
- Jurisprudence

The Law is Different in Each State!

- States vary regarding conduct that constitutes bad faith.
- California, Arizona, New York, and Florida are among states with the most stringent interpretations of the standard of conduct, whereas in Mississippi punitive damages are disfavored.
- *Many states apply different standards for bad faith or have different causes of action available*

First Party v. Third Party Claims

- Within each state, there is a disparity in the law on bad faith claims depending on whether they are brought by a primary or a third party.

- First party claims are most often for failure to pay, or failure to investigate, a claim.

- Third party claims, when available, are often for failure to defend, indemnify, or settle a claim within policy limits.

Common Issues of Bad Faith in Claims Handling

- Misrepresentations made to delay or avoid paying a claim
- Misinterpretation of policy language and coverage
- Denial of a claim based on improper legal standard
- Failure to investigate, or unreasonable demands of proof in the investigation of a claim
- Failure to settle, or improper or coercive tactics in the settlement of a claim
- Failure to disclose or explain an insured's policy

Expansion of Duty and the Effect on Claims Professionals During Litigation

An insurers conduct after the commencement of a bad faith action is increasingly considered by the jury in reaching a verdict.

- In *O'Donnell v. Allstate Ins. Co.* the Pennsylvania Supreme Court held that an action for bad faith may extend to the insurer's investigative practices in a litigation, and possibly during the pendency of or for initiating an action.
- A court in Georgia held an insurer liable for continuing to decline to make medical payments after a lawsuit was initiated, in *United Servs. Auto Ass'n v. Carroll*.
- A Kentucky statute providing an action for bad faith was read to include insurer conduct before *and* after the commencement of litigation. The court distinguished conduct after litigation from litigation strategy and technique in *Knotts v. Zurich*.

Insurer's Duty to Settle

- Insurer's duty to settle arises when there is a reasonable probability of recovery in excess of policy limits, and a reasonable probability of a finding of liability of the insured against whom the claim has been made, *Haddick v. Valor*.
- Factors courts consider in determining whether there was a bad faith breach of the duty to settle:
  - Advice of insurer's own adjusters
  - Refusal to negotiate
  - Advice of defense counsel
  - Communication with the insured, keeping them fully aware of claimant's willingness to settle for the amount of coverage
  - An adequate investigation and defense
  - Substantial prospect of an adverse verdict
  - Potential for damages to exceed policy

O'Neill v. Gallant Insurance Co., 769 N.E.2d 100 (Ill. App. 3 Cir. 2002).

Conduct During Litigation Can Be Evidence of Bad Faith

- An insurer's **claim file** (broadly defined by courts)
- Insurer reserves
- And in some cases, an insurer's *pleadings in the litigation* are admissible as evidence in a bad faith claim.

What you thought was privileged, may not be in certain venues - need to assume anything in your claims file may be discoverable.

How much of a claim file is discoverable by opposing counsel?

- Claim files are generally not protected by work-product privilege or attorney-client privilege, regardless of whether they were prepared by an attorney.

  Most courts review files for attorney-client privilege on a case-by-case basis; material may be protected if prepared in anticipation of litigation

- Whether reserves are discoverable varies widely, it is important to know the law in your state.

How to Avoid Bad Faith

- How to avoid liability:
  - Keep detailed records, regularly. This includes a record of lapses in diligence, to ensure they are not repeated.
  - Be aware of legal and ethical standards relevant to claims practice.

Ethical Considerations

- An insurer contracts with an insured to protect the *insured's* interests
- It is imperative to keep the insured's best interests in mind:
  - In reviewing and interpreting coverage
  - In discovering and conveying information about claims and settlement
  - Fairly estimate damages
- Insurers must be honest and thorough in the investigation of claims without bias
  - Work towards resolution in favor of *all* parties
  - Keep all parties informed, and answer questions honestly
  - This includes investigating information received from interested parties
- Report unethical conduct to superiors

Ethical Requirements of Claims Professional (Florida)

69B-220.201 Ethical Requirements for All Adjusters and Public Adjuster Apprentices.

(3) The work of adjusting insurance claims engages the public trust. An adjuster shall put the duty for fair and honest treatment of the claimant above the adjuster's own interests in every instance. The following are standards of conduct that define ethical behavior, and shall constitute a code of ethics that shall be binding on all adjusters:

(a) An adjuster shall not directly or indirectly refer or steer any claimant needing repairs or other services in connection with a loss to any person with whom the adjuster has an undisclosed financial interest, or who will or is reasonably anticipated to provide the adjuster any direct or indirect compensation for the referral or for any resulting business.

(b) An adjuster shall treat all claimants equally.

1. An adjuster shall not provide favored treatment to any claimant.

2. An adjuster shall adjust all claims strictly in accordance with the insurance contract.

(c) An adjuster shall not approach investigations, adjustments, and settlements in a manner prejudicial to the insured.

(d) An adjuster shall make truthful and unbiased reports of the facts after making a complete investigation.

(e) An adjuster shall handle every adjustment and settlement with honesty and integrity, and allow a fair adjustment or settlement to all parties without any compensation or remuneration to himself or herself except that to which he or she is legally entitled.

(f) An adjuster, upon undertaking the handling of a claim, shall act with dispatch and due diligence in achieving a proper disposition of the claim.

(g) An adjuster shall not negotiate or effect settlement directly or indirectly with any third-party claimant represented by an attorney, if the adjuster has knowledge of such representation, except with the consent of the attorney. For purposes of this subsection, the term "third-party claimant" does not include the insured or the insured's resident relatives.

(h) An adjuster shall not advise a claimant to refrain from seeking legal advice, nor advise against the retention of counsel or the employment of a public adjuster to protect the claimant's interest.

(i) An adjuster shall not attempt to negotiate with or obtain any statement from a claimant or witness at a time that the claimant or witness is, or would reasonably be expected to be, in shock or serious mental or emotional distress as a result of physical, mental, or emotional trauma associated with a loss. The adjuster shall not conclude a settlement when the settlement would be disadvantageous to, or to the detriment of, a claimant who is in the traumatic or distressed state described above.

(j) An adjuster shall not knowingly fail to advise a claimant of the claimant's claim options in accordance with the terms and conditions of the insurance contract.

(k) An adjuster shall not undertake the adjustment of any claim concerning which the adjuster is not currently competent and knowledgeable as to the terms and conditions of the insurance coverage, or which otherwise exceeds the adjuster's current expertise.

(l) No person shall, as a company employee adjuster or independent adjuster, represent him- or herself or any insurer or independent adjusting firm against any person or entity that the adjuster previously represented as a public adjuster.

Practical Tips & Strategy

- **MAINTAIN A THOROUGH CLAIM FILE**
  - Document effort to respond promptly to each inquiry from a policy-holder
  - Settlement offers must be reasonable and fair, based on the facts at hand and relevant law
  - Do not deny coverage without an adequate (and documented) investigation
  - Respond promptly to claimant attorneys' deadlines
  - Communicate with interested parties, especially the insured during an investigation
  - Properly consider advice of counsel when recommendations to settle or there is potential for jury verdicts in excess of policy limits

Panel Hypotheticals to discuss the legal and ethical considerations facing a Claims Professional on a daily basis as it relates to potential Bad Faith Claims

Hypothetical # 1

Claims attorney handling claims-made product liability coverage learns in the context of handling a claim file that an insured manufacturer of FDA regulated pharmaceuticals may not have accurately disclosed testing results to the FDA. The Insured's in-house counsel will not provide full and complete copies of testing data to the insurer, and additionally indicates to assigned defense counsel that the insured will do everything it can to avoid producing the testing data in discovery.

How will the insured's lack of cooperation affect coverage? Should the claims handler make anonymous disclosures to the FDA?

Hypothetical # 2

Claims attorney handling medical malpractice claims learns from in-house counsel in the context of handling a bodily injury lawsuit that an insured medical facility may be overbilling Medicare. The claims attorney knows that the claimant's counsel is a "hard-charger" and is likely to use any means at his disposal to artificially boost the value of his client's claim.

When the claimant's attorney sends discovery seeking the billing records of his client (a Medicare recipient), what are the claims handler's options? Should the claims handler advise Medicare?

Hypothetical # 3

Claims attorney is handling a claim involving an insured escrow company that is alleged to have converted closing funds it held for a substantial real estate transaction. The claims attorney, searching the internet, discovers that one of the partners in the escrow company has a felony conviction. The claims handler has always thought this particular individual was suspicious, and in fact, truly believes that this partner converted the money.

Should the insurer issue a reservation? Should the handler issue that reservation? Should the handler enlist the assistance of assigned panel counsel to investigate the partner's potential involvement?

Hypothetical # 4

Claims attorney is traveling to a mediation on a lawyer's professional claim, and wants to be prepared. So, she takes a copy of the insured's policy, including the application and supplements, to help her discuss the rather thorny coverage issues facing the insured. She has the complaint, the insured's discovery answers, the policy information and underwriting file materials in a red-weld folder. After numerous delays and gate changes, her flight leaves at midnight from O'Hare and arrives in LA at 2am. Upon arriving at the luxurious Marriott Courtyard in Century City, she realizes that she accidentally left the red-weld on a chair at Gate 29, terminal 1.

What if anything should she do?

Hypothetical # 5

Claims attorney is handling a matter for a real estate agent, and it is clear from the claim materials submitted that a homebuyer is experiencing a bit of buyer's remorse and wants the insured to pay for some upgrades the claimant feels he is entitled to receive. The claimant does this by alleging that the insured engaged in double dealing and a conflict of interest/breach of fiduciary duty by failing to inform the claimant that the house really wasn't worth it, and that the claimant should have backed out of the deal. The claimant demands $10,000 or he will file suit. The claims attorney knows this is extortion and that there is a small likelihood that the claim ever exceed the Insured's $10,000 deductible. The claims attorney recommends that the Insured simply pay the $10,000 to the claimant, since if suit is filed, the $10,000 deductible will be gone anyway.

Is this recommendation appropriate? Is it proper for the claims attorney to attempt to negotiate on behalf of the Insured and seek a release from the claimant? Is the answer the same if the claimant alleges the insured converted $10,000?

Hypothetical # 6

An insured property manager with several pending E&O claims tenders yet another to his E&O carrier. The claim is a pro-se lawsuit alleging almost every conceivable intentional cause of action, all allegedly resulting in property damage and emotional distress. The insured tells the claims attorney that he will probably handle this claim on his own since the last thing he needs is another claim on his loss history. The claims attorney suggests that the insured should withdraw the claim because it probably isn't covered anyway, due to the absolute property damage exclusion on the policy. The insured says he'll think about it. On the day before the answer is due, the claims attorney hasn't received a response from the insured, and the insured isn't answering his phone, with his voicemail stating he's out of the country.

What should the claims attorney do?

Hypothetical # 7

Insurance carrier begins its investigation of an insured attorney's request for a defense against a legal malpractice suit. During its initial investigation, the carrier learns that the underlying allegations arise more out of the insured's attorney's services as the accountant and trustee of a Trust over which the insured attorney administers. The carrier retains coverage counsel to assist in its determination as to whether a defense is owed to the insured attorney. In conducting the coverage analysis, the retained coverage counsel recommends a course of action for further investigation of the claim, including acquisition of documents, interviews of various personnel and third party witnesses. Coverage counsel also participates in roundtable discussions with the carrier's claims professionals assigned to investigate the claim. The log activity notes documents all of these discussions, including recommendations made by coverage counsel and the outline for the claims investigation. After denying the request for a defense, the insured attorney sues for bad faith. The carrier does not raise advice of counsel as an affirmative defense. During discovery, the insured attorney requests a complete copy of the claims file, including all log activity notes. The carrier objects to producing a majority of the claims file on the basis of attorney-client privilege.

What should they have done differently? Is the claims file discoverable?

Special Thanks To Our Panel:

Glenn Fischer – Markel Corporation

Kim DeMarino – Great American Insurance Group

Richard Gatz – Starr Adjustment Services Inc.

Allan Jones – Carr Allison (AL)

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