



# Good Faith, Bad Faith: A Legal View

An ICAC Publication

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The purpose of Good Faith/Bad Faith is to serve as a compendium of general information insurers may wish to use as part of the development of their own individual claims-handling procedures; however, Good Faith/Bad Faith neither sets forth any particular practice or policy as a recommendation or best practice nor does it represent a compilation of widely followed procedures.

Good Faith/Bad Faith ALV should be viewed as one of many possible sources of information that an individual insurer may wish to reference and evaluate in establishing corporate procedures. This approach reflects the philosophy behind the Insurance Committee for Arson Control (ICAC). In keeping with that philosophy, any views, positions, or interpretations of the law expressed herein are those of the contributing author and are not necessarily those of ICAC or any member of ICAC.

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## I. The Duty of Good Faith and Fair Dealing

Any discussion on the subject of insurer bad faith can begin with the relationship that exists between an insurer and its insured. Every contract of insurance that creates such a relationship carries an implied duty of good faith and fair dealing between the two parties. This duty is necessary to ensure that the parties do not try to take unfair advantage of each other or do anything to impinge on or destroy each other's right to receive the benefit of the contract.<sup>1</sup>

Most often, education on the subject of bad faith is focused on whether an insurer properly reached a coverage decision, i.e., whether there was a bona fide dispute or fairly debatable basis for the insurer's interpretation and application of the relevant law and policy language. As a result, insufficient attention is paid to an insurer's conduct before reaching an adverse coverage decision, where subjects such as predisposition, negligent hiring of experts, lack of objectivity, inadequate investigation, or improper information sharing can become significant. It is during this period of time that evidence of bad faith can originate, and it is in this area of the claim file that insurers and their attorneys must focus on determining whether an exposure for bad faith exists.

***“Contract law requires the parties to an agreement to do more than just fulfill the contract terms. The law also sets standards for the way you and the other party conduct yourselves throughout the transaction. The legal system punishes those who engage in trickery and act in bad faith... .”***

Fraud, Misconception, Good Faith and Fair Dealing, Lawyers.com

In addition, when an insurance company denies a claim and is subsequently sued by its insured, the insurer may lose sight of its ongoing duty of good faith and fair dealing to the insured after a suit is filed. An insurer's good faith obligations to its insured are not suspended when the insurer gets sued. Therefore, if an insurer is not careful, its conduct during litigation may also be used to support a cause of action for bad faith

Even a cursory search of bad faith on Google will uncover numerous websites authored by members of the plaintiff's bar that are clearly designed to formulate a unified attack on the insurance industry. One website in particular discusses “the best way to set up [entrap] an insurance company...” Other websites offer “litigation kits” that include discovery pleadings, outlines for deposing claims staff, and suggestions on the materials to request from insurance companies in an effort to build a successful bad faith case.

Although the insurance industry has attempted to anticipate and forestall these developments by educating staff and stressing the importance of good faith claims handling to their employees, attorneys for policyholders continue to innovate and find means of attacking insurers. The insurance industry is diligent in its efforts to address such attacks, but is often left subject to appellate court decisions that do very little to clarify the law or level the playing field.

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<sup>1</sup> Conti v. Republic Underwriters Ins. Co., 782 P.2d 1357, 1362 (Okla. 1989); see Oulds, 6 F.3d at 1436 citing McCoy v. Oklahoma Farm Bureau Mut. Ins. Co., 841 P.2d 568, 572 (Okla. 1992).



## **Bad Faith Defined**

How bad faith is defined varies from state to state, but most jurisdictions have relatively similar interpretations. Generally speaking, for an insured to prevail on a bad faith claim: “(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 knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed.”<sup>2</sup>

Differences among states, however, do exist. For example, in Alabama, there are two forms of bad faith – “normal” and “abnormal.” Normal bad faith requires the plaintiff to prove the following: “(1) the existence of an insurance contract; (2) an intentional refusal to pay the claim; (3) the absence of any lawful basis for such refusal; and (4) the insurer’s knowledge of its intentional failure to determine whether there is any lawful basis for its refusal.”<sup>3</sup> For such a claim to be presented to the jury, the “the underlying breach of contract claim must be so strong that the insured would be entitled to a pre-verdict judgment as a matter of law.”<sup>4</sup>

Abnormal bad faith requires a showing of “(1) intentional or reckless failure to investigate a claim; (2) intentional or reckless failure to properly subject a claim to cognitive evaluation or view; (3) the manufacture of a debatable reason to deny a claim; or (4) reliance on an ambiguous portion of the policy as a purportedly lawful basis for denying a claim.”<sup>5</sup> Thus, abnormal bad faith cases dispense with the issue of a pre-verdict judgment as a matter of law for the plaintiff if the insurer “recklessly or intentionally failed to properly investigate a claim or to subject the results of its investigation to a cognitive evaluation.”<sup>6</sup>

You will, of course, want to be familiar with any special interpretations that may exist in the state where the claim originates.

## **Defenses to Bad Faith**

One of the first issues to examine in determining whether an insurer has a viable defense to a bad faith claim is whether an insurance company’s claims handling or coverage decision was unreasonable and vexatious.<sup>7</sup> Courts have concluded that an insurer’s delay or other action is not vexatious and unreasonable if a bona fide coverage dispute exists.<sup>8</sup>



<sup>2</sup> Cowan v. Paul Revere Life Ins. Co. 30 Fed. Appx. 384, 388 (6th Cir. 2002).

<sup>3</sup> Jones v. ALFA Mutual Insurance Company, 2008 WL 2406132, \*8; 1 So. 3d 23, 32 (Ala. 2008) (Ala. June 13, 2008).

<sup>4</sup> Id.

<sup>5</sup> Id.

<sup>6</sup> Id.

<sup>7</sup> McGee v. State Farm Fire & Casualty Co., 315 Ill. App. 3d 673, 683, 734 N.E.2d 144 (2000) (“The relevant inquiry to determine whether an insurer’s actions were ‘unreasonable and vexatious’ is whether it had a bona fide defense to the claim”).

<sup>8</sup> Golden Rule Ins. Co. v. Schwartz, 203 Ill. 2d 456 (2003).

It is well settled that if there is a bona fide dispute regarding coverage, bad faith damages are not an appropriate remedy.<sup>9</sup> Thus, an insurance company does not commit bad faith merely by unsuccessfully challenging a claim.<sup>10</sup>

It should also be noted some states, Illinois for example, has long held that an insurance carrier is entitled to determine what documents and information are significant to its investigation.<sup>11</sup> In *Waste Management, Inc. v. International Surplus Lines Ins. Co.*, the Illinois Supreme Court provided the following guidance:



**The insurer is entitled, irrespective of whether its duty is to defend or to indemnify, to gain as much knowledge and information as may aid it in its investigation, or as may otherwise be significant to the insurer in determining its liability under the policy and in protecting against fraudulent claims.** To hold otherwise effectively places the insurer at the mercy of the insured and severely handicaps it in contesting a claim. **[Emphasis added.]**

Similarly, other courts have held that to assert the genuine dispute doctrine as an affirmative defense to bad faith, the insurer must have conducted a proper investigation of the claim, including investigation of all possible bases for coverage of an insured's claim. In *Jordan v. Allstate Ins. Co.* questions<sup>12</sup> of fact existed as to whether Allstate had investigated all possible bases of coverage, in that Allstate had not retained a structural engineer; did not communicate the existence of "collapse" coverage to the insured; did not perform destructive testing; did not interview the insured; and did not further investigate because the insured never presented a formal claim.

That said, charges that an insurer took too long or was wrong with its decision to deny the insured's claim will likely be raised in most lawsuits involving insurance coverage, fraud, and bad faith. To strengthen defenses in this area, insurers should emphasize to their claims staff the importance of:

- Conducting a reasonable, good faith, and prompt investigation;
- Ensuring all provisions of the policy are fully followed and applied to the claim;
- Maintaining a well-documented claims file that outlines the steps of the investigation and explains the basis for any delays;
- Ensuring that red flags used to justify a lengthy investigation are material and relevant to the circumstances of the claim;
- Adhering to the contractual and regulatory timelines for reaching decisions and that communication with the insured is maintained during the course of an investigation; and
- Ensuring that all coverage rights are properly reserved.

Employing these standards will significantly bolster an insurer's defense against a charge of bad faith delay.

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<sup>9</sup> *Baxter Int'l., Inc. v. American Guarantee and Liability Ins. Co.*, 369 Ill. App. 3d 700, 710, 861 N.E.2d 263 (1st Dist. 2006); *Lyon Metal Products, L.L.C. v. Protection Ins. Co.*, 321 Ill. App. 3d 330, 747 N.E.2d 495 (2nd Dist. 2001); *Kohlmeier v. Shelter Ins. Co.*, 170 Ill. App. 3d 643, 525 N.E.2d 94 (5th Dist. 1988).

<sup>10</sup> *Buais v. Safeway Insurance Co.*, 275 Ill. App. 3d 587, 591, 656 N.E.2d 61 (1995).

<sup>11</sup> See *Waste Management, Inc. v. International Surplus Lines Ins. Co.*, 144 Ill. 2d 178, 579 N.E.2d 322 (1991).

<sup>12</sup> *Jordan v. Allstate Ins. Co.*, 56 Cal. Rptr. 3d 312 (Cal. Ct. App. 2007) ("Jordan II").



## II. Issues That Create an Exposure for Bad Faith

The following represents issues for insurance companies and their claims staff that have potential to generate claims of bad faith. While it is not an exhaustive list, it does provide exposure to typical questions/situations.

***“To successfully avoid and defend against bad faith, insurers must focus on four key areas of exposure: coverage, investigation, evaluation, and initiating settlement.”***

Avoiding and Defending Against Bad Faith, Dennis J. Wall

### ***Whether an insurance company has a duty to reopen or reconsider prior denials***

In *Brown v. U.S. Fidelity and Guaranty Co.*,<sup>13</sup> the Arizona Court of Appeals considered whether an insurer has a duty to either reopen its claims file or to reconsider an earlier denial. This question is answered by examining whether the initial investigation was adequate and whether the ultimate decision to deny coverage was reasonable. “[O]nce the duty to use good faith in considering insurance claims has been breached, the insurer cannot later seek to justify its denial by gathering information which it should have had in the first place.”

### ***Lengthy investigations – Williams v. Hartford Casualty Insurance Co.***<sup>14</sup>

In this case, the court held that even though a quicker resolution may have been possible in settling a claim, an insurer does not necessarily act in bad faith by conducting a lengthy investigation. In this case, the insurer took 15 months to complete its investigation.

### ***Inadequate Investigations – Texas Farmers Insurance Co. v. Cloteal Cameron***<sup>15</sup>

The appellate court held that the insurer acted in bad faith and violated the Texas Insurance Code by denying a fire claim on arson grounds without verifying the insured’s alibi statement and without sufficiently checking the insured’s financial records. Insofar as damages, the appellate court reduced the overall amount awarded to the insured by the trial court; however, it sustained certain amounts awarded for bad faith and emotional distress.

### ***Exposure for Defamation – Henry Dale Overcast v. Billings Mutual Insurance Company***<sup>16</sup>

In this case, the insured’s home was destroyed by fire, and following the investigation the insurer sent a denial letter to the insured stating that “the loss resulted from an intentional act committed by you or at your direction.” The letter was addressed solely to the insured and was sent by registered mail, return receipt requested.

The insured filed suit for, among other things, breach of contract and defamation. On the insured’s claim for breach of contract, the trial court entered a judgment for \$26,990 plus interest for damages. On his claim for defamation, the jury returned a verdict of \$500,000 actual damages and \$400,000 in punitive damages. The insurer subsequently appealed arguing, in part, no recovery for defamation was due because there was no publication of the denial letter to any third party and that there was an absolute privilege for an insurer to communicate the reason for a denial to its insured.

<sup>13</sup> *Brown v. U.S. Fidelity and Guaranty Co.*, 977 P.2d 807 (Ariz. Ct. App 1998).

<sup>14</sup> *Williams v. Hartford Casualty Insurance Co.*, 83 F. Supp. 567 (E.D. Pa. 2000).

<sup>15</sup> *Texas Farmers Insurance Co. v. Cloteal Cameron, et al.* 24 S.W.3d 386 (Tex. Ct. App. 2000).

<sup>16</sup> *Henry Dale Overcast v. Billings Mutual Insurance Company*, 11 S.W.3d 62 (Mo. 2000).

The insurer argued that without an absolute privilege to issue denial letters, its hands would be tied because it must inform its insureds of the reason for any denial of claims. However, the appellate court was not persuaded and noted that



[A]n insurance company will not be liable for defamation if it sends its denial letters with stated reasons after a fair and thorough investigation that develops substantial evidence to support its decision.

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The court does not mean to say that reasons for denying a claim should not be given. In fact, if only for good customer relations, insurance companies would state a reason for denying a claim. However, where a reason is given, the basis for denying a claim must ultimately be valid and supported by the insurance company's investigation.

### ***Emotional Injury – William Hall v. Allstate Insurance Company and Rebecca Bailey***<sup>17</sup>

The insured alleged that the actions of the carrier in denying his claim and accusing him of fraud were “extreme and outrageous and taken with the explicit intent of denying [his] benefits due him pursuant to the [policy of insurance].” He further alleged the intention to cause his reputation “to be besmirched in the community including ... loss of esteem ... humiliation and embarrassment.”

The court determined that Allstate's conduct did not meet the level of “extreme and outrageous” behavior required and determined that the trial court properly granted summary disposition in favor of Allstate on the insured's intentional infliction of emotional injury claim. The court seemed to base its ruling, in part, on the fact that Allstate conducted a reasonable investigation and that it had a good faith basis for the coverage decision it reached.



The mere fact that Allstate and the...investigator reached the conclusion [ultimately determined by the jury to be erroneous] that the claim was fraudulent, **without evidence of harassment or the absence of a good faith basis upon which to deny the claim**, does not constitute extreme or outrageous conduct or an intent to cause emotional injury. **[Emphasis added.]**

It seems safe to say that if the carrier's investigation had not been viewed as reasonable and conducted in good faith, the court would have reached a far different decision in this case.

### ***Request for the Personnel Files of Claim Adjusters and Managers – Eleanor C. Moss as Personal Representative of the Estate of Roy L. Moss v. GEICO Indemnity Co.***<sup>18</sup>

The discovery process is one of the most important and challenging areas of litigation in a bad faith/punitive damages case and may lead to or be a source of proving/finding bad faith. Insurers are often requested to produce information that they consider to be sensitive and confidential, and court intervention is usually required to settle disputes over what should be turned over in discovery. One of the most hotly contested debates on this subject arises when a policyholder (or in some states any claimant) makes a request for an adjuster's personnel file.

<sup>17</sup> William Hall v. Allstate Insurance Company and Rebecca Bailey, 2009 Mich. App. LEXIS 2656 (Mich. Ct. App. December 22, 2009).

<sup>18</sup> Request for the Personnel Files of Claim Adjusters and Managers – Eleanor C. Moss as Personal Representative of the Estate of Roy L. Moss v. GEICO Indemnity Co. – No. 5:10-cv-104-Oc-10TBS, U. S. Dist. Ct. Middle Dist. of Florida, Ocala Div., (March 2, 2012).



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Needless to say, personnel files are closely guarded because they usually contain private information regarding an employee's residence, family, compensation, work performance, and other confidential and sensitive information.

That said, it appears that adjusters' personnel files are getting increased attention as a potential target of discovery in bad faith and punitive damages cases. The reason is that many attorneys are under a misguided belief that insurance companies set goals for claims handling other than investigating and paying legitimate claims. These misguided beliefs or assumptions include financial goals for denials or underpayments; timing goals related to slowness or timeliness; expectations regarding communication with insureds; etc. As a result, there's a constant search for "evidence" that might reflect the existence of a corporate program that rewards claims personnel for minimizing the payment of claims. In virtually every case, however, no such evidence is found to exist. Nevertheless, discovery requests for this type of information is apparently becoming more frequent.

In the GEICO case, the plaintiff filed a bad faith suit against the carrier after an excess verdict in an underinsured motorist suit. During discovery, the insured's attorney asked the carrier to produce the personnel and/or training files of the claims manager and every claim representative who handled any aspect of the claim. The insurer objected and argued that the materials were irrelevant, confidential, and an undue invasion of its employees' privacy.

The court acknowledged that a request for a personnel file raises serious concerns about the privacy rights of an employee who is not a party to the litigation but whose information is sought. Nonetheless, the court opined that personnel files often contain information that reflects an employee's training, competence, abilities, shortcomings, accolades, and disciplinary history, if any, and that all such information is relevant to a claim for extra-contractual damages and should be produced. However, the court stopped short of requiring GEICO to produce the entire contents of its adjuster's personnel file and held that information regarding compensation, health, benefits, pensions, etc., was irrelevant to the plaintiff's bad faith action and was not necessary to produce.

In ruling, the judge commented that personnel files contain private information and that courts must exercise caution in permitting the discovery of information that might embarrass non-party employees, especially when the information sought may be obtained from other less intrusive sources:



While the employees and their supervisors can be deposed concerning these matters, the [personnel] files may be the most reliable source for some of the information. They may be helpful to refresh the witnesses' memories and they might be used for impeachment. While the Court has found that information in the personnel files concerning the employees' training, competence, abilities, shortcomings, accolades and disciplinary history is relevant, it also concludes that it is appropriate to implement safeguards to address the legitimate concerns raised by the defendant and the privacy rights of the non-party employees. [Therefore], the information may only be used in the litigation of this case and for no other purpose. The information shall not be shared with anyone who does not have a legitimate need to know the information on account of their involvement in this case.

Most courts recognize that adjusters who are not a party to litigation have a recognized privacy right with regard to information maintained by their employers. Therefore, when an insurer is faced with the prospect of being ordered to produce portions of an adjuster's personnel file, a protective order should be considered to preserve the confidentiality of any proprietary information that may be contained in the material to be produced; and, the protective order should likely extend to all documents produced in response to the document request in question. Finally, a demand should be made to allow for the redaction of any information that is considered privileged and/or confidential.

### III. Competent Experts

#### ***The Selection and Vetting Process – Nadzira Ficic v. State Farm Fire & Casualty Co.*** <sup>19</sup>

In a typical fire investigation, an insurer will usually hire an origin and cause expert to determine whether the fire was accidental or intentional. Thus, if a fire is determined to be incendiary, i.e., arson, a defense to coverage may exist if sufficient evidence points to the insured.

Although it is the responsibility of an origin and cause expert to determine a fire's causation, it is not uncommon for an expert to eliminate all possible accidental causes of a fire, and still be unable to conclude, within a reasonable degree of scientific certainty, that a fire was intentionally set.

In such cases, the question that arises is whether an insurer may properly deny coverage if there is, arguably, other evidence sufficient to establish that the insured intentionally caused the loss. In this case, the insured, Nadzira Ficic, purchased a 1995 Cadillac from a used car dealer in early 1997. During the first few months after the purchase, she returned it to the dealer three times for repairs, including once for an electrical problem. On May 20, 1997, Ficic loaned the car to her brother, Vincent Ficic, and their uncle, Bari Ficic, who rode as a passenger. While driving the vehicle, Vincent Ficic claimed to have noticed smoke coming from the front dashboard vents and pulled the vehicle over to the shoulder of the expressway. Both occupants claimed to have exited the vehicle just as it burst into flames, and they both denied smoking or dropping a cigarette or a match in the vehicle prior to the fire.

***“In many cases, and in virtually all fire litigation cases, [a] form of testimonial evidence will be used: the testimony of an expert witness. The expert witness is allowed to do something that no other witness can do in the case – provide opinion testimony on the meaning of evidence.”***

Avoiding Bad Faith in Claims Involving Fire Experts, Glenn Gibson,  
Guy E. (Sandy) Burnette, and Joseph P. Toscano

After an investigation, State Farm denied Ficic's claim, alleging that her brother and uncle started the fire with a lighted cigarette on the car's floor behind the driver's seat. The insured sued for coverage and State Farm asserted an affirmative defense of fraud by arson against the insured. In a separate action, State Farm sued the insured's brother and uncle, alleging they acted on behalf of the insured by intentionally burning the vehicle and, thereby, facilitating her fraudulent claim.

State Farm's expert witness at trial referred to himself as a “consulting engineer.” The insured's attorney did not conduct an in-court review of his qualifications as an expert. Therefore, without objection, the expert was permitted to give opinion testimony in the field of automobile mechanics and fire investigation.

The expert testified that the fire originated on the floor of the car behind the driver's seat. He based his testimony on an inspection of the burn patterns within the vehicle's interior and further characterized the fire as “suspicious.” In his closing argument to the jury, the attorney for State Farm argued that, based upon expert opinion, since the fire did

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<sup>19</sup> The Selection and Vetting Process – Nadzira Ficic v. State Farm Fire & Casualty Co. No. 12861/98 N.Y. Sup., Richmond County ; N.Y. Misc LEXIS 679.



not result from a defect in either the fuel line or the electrical system, and if one rules out an accidental cause such as accidentally dropping a match or cigarette “that leaves only one thing, that leaves arson.”

The jury heard no testimony to refute or question the expert’s opinion that the fire was suspicious, and the sole question presented to the jury was “Did the plaintiff have the fire intentionally started in order to damage her property for the purpose of recovering on the insurance policy?” A majority of five out of the six jurors answered “yes” and found in favor of State Farm in both cases.

The plaintiffs subsequently filed a post-trial motion noting that State Farm was required to demonstrate by clear and convincing evidence that the insured intentionally caused the fire to be set. In other words, was the expert’s opinion that the fire was “suspicious,” a generally accepted opinion within the fire investigative community and was the evidence sufficient to support the verdict of the jury?

In considering the insured’s post-trial motion, the court stated that the expert’s opinion was based on conjecture and speculation. The court noted that he was unable to detect the point of origin or defect that caused the fire; and, he found no combustible material in the vehicle. He also allegedly could not say how the fire started or whether accelerants were used to ignite the fire. Moreover, on cross-examination, the expert was unable to rule out the possibility that the fire was accidental and could not state whether the fire was intentionally set.

The court noted that the expert was a member of the International Association of Arson Investigators (IAAI) and that the IAAI’s website reflects that its members should utilize the National Fire Protection Association’s Guide for Fire and Explosion Investigations, or NFPA 921. The court took particular note of the portion of the text of NFPA 921 that states:



The cause of a fire may be classified as accidental, natural, incendiary (arson) or undetermined. Use of the term suspicious is not an accurate description of a fire cause. Mere suspicion is not an acceptable level of proof for making a determination of cause within the scope of the guide and should be avoided. Such fires should be classified as undetermined.

The court further noted that it was the expert’s membership in an organization such as the IAAI that gave him some of the necessary training to even hold himself out as an expert in the field of arson investigation. “Therefore, he should comply with their training and their generally accepted published standards or he should have explained, when given the opportunity by this court, that they are not relevant.”

Based on the above-stated analysis, the court held that the opinion of the expert must be stricken and disregarded, as his opinion was invalid and not reliable because it was not based on the generally accepted scientific classifications for the causation of fire within the fire investigation community.

NFPA 921 has arguably become an industry standard for investigating fires, explosions, and other disasters. While NFPA 921’s stated purpose suggests that the document is a guide, some courts have held that it is authoritative and that it may be used as a standard. In that regard, experienced fire investigators have had their testimony barred at trial because they did not follow the basic principles of NFPA 921.

Therefore, insurers should be mindful of the extent to which their fire experts are knowledgeable and familiar with NFPA 921. Suffice it to say, fire investigators who are knowledgeable with and employ NFPA 921 will be better equipped to meet the challenges to their opinions, and can also use it to support their conclusions and their investigative analysis.

## IV. Information Sharing

It has long been said that sometimes we are our own worst enemy. That can be especially true for insurance carriers when it comes to sharing information in the battle against insurance fraud. This is extremely important as these claims often give rise to subsequent bad faith litigation. If you ask any claims or special investigation unit (SIU) professional, he or she will tell you one of the best ways to battle insurance fraud is openly share information so carriers are alerted to fraudulent activities and individuals. While on the surface, this commitment to sharing information in the battle against insurance fraud is almost universal, the actual application of sharing information is often times non-existent or extremely poor. In truth the most active communication we often share is talking about adverse bad faith verdicts or court decisions after the fact instead of properly sharing information in advance that may have helped prevent those unfortunate results.

There have been many reasons for the failure to openly share information. These include the lack of direct immunity in many jurisdictions for sharing information between insurance carriers, the desire to seek a competitive advantage against others in the industry, and the lack of a well-defined channel or network through which information may be appropriately conveyed and disseminated. Another sad reality is those who commit insurance fraud as well as both civil and criminal attorneys who represent and defend them are much better at sharing information than are insurance carriers and members of the defense bar. The confluence of these events and actions has been to tacitly allow fraud to continue unabated simply because of the lack of sharing valuable and insightful information.

This problem exists not only between insurance carriers, but sometimes even within individual corporate structures. Amazingly, there have been reported situations where one division, department, or separate policy-writing incorporated entity refused to share directly relevant information concerning insurance fraud with another department or corporate entity under the same parent or group ownership. The insurance industry, while not being federally regulated, is still highly regulated at the state level. In an abundance (or possibly overabundance) of caution, many insurance carriers have placed many layers of bureaucratic review, and often times even unnecessary restrictions, out of the fear of doing something wrong or being held accountable.





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During the course of an investigation of a major medical fraud ring in 2001, a meeting was called by the United States district attorney, who was investigating the medical fraud ring. Approximately 20 insurance carriers were invited to attend with the hope of sharing information for possible prosecution. Six months after the meeting, the district attorney's office abandoned the investigation for a number of reasons, among those was the refusal of insurance carriers to release information without an agreement the information would not be shared with their competitors. The net result was that this contributed to allowing fraudulent activities to continue too many years thereafter unabated.

In contrast, insurance carriers do a much better job of sharing information concerning insurance fraud with public-sector law, fire, and state insurance agencies. Virtually all states have now adopted various laws affecting or mandating the exchange of information between insurers and public-sector investigators. While there has been no model or uniform law established, in most jurisdictions the law mandates an insurance carrier to turn over the entirety of its claim and investigative file information when requested by an appropriate public-sector investigation agency. Failure to provide the requested information may lead to fines, penalties, or even suspension of state insurance licensure. Most carriers realize the seriousness of these requests and, either directly or through legal counsel, are usually willing to respond in full.

Although there are some exceptions, most state immunity statutes do not mandate but instead allow the public-sector investigator to turn over materials as he/she deems appropriate to a requesting insurance carrier. This creates an unequal situation but has been justified on the basis of the public sector not wanting to potentially prejudice or turn over materials improperly that may be relevant to a criminal prosecution. As those involved in the investigation of insurance fraud are aware, however, based on the amount of fraud that occurs in the United States, there is minimal criminal prosecution for these actions and activities. All too often public-sector investigators use the immunity statute to mandate insurers turn over information, but then restrict or wholly ignore requests that are in turn received validly from insurers requesting similar information.

While no insurance carrier should ever interfere in any regard with an ongoing criminal investigation or prosecution, it would certainly improve the flow of information and communication in the battle against insurance fraud if public-sector investigators were willing to more carefully review requests for immunity releases received from insurance carriers or note in their files to provide the information subsequently if it is determined criminal prosecution will not occur. Instead, these requests are routinely denied, ignored, or, long after criminal prosecution, abandoned, without consideration that the information is a valuable asset to insurers in the fight against future fraudulent claims and bad faith litigation. Insurance carriers, in like manner, should consider making renewed requests to public-sector investigators if they learn that criminal prosecution is not being pursued. Too often, those in the insurance industry also fail to follow up and keep a proper line of communication open for the sharing of this vital information.

It is imperative in this era of claims and SIU consolidation to be keenly aware of each individual state's immunity laws, protections, and potential pitfalls. Most departments of insurance will readily provide information concerning immunity. You can also check with your local defense counsel to make certain all requests received are responded to on a timely basis and to verify what information and exchange may properly be requested from the public-sector investigation agencies or even between insurance carriers directly or through third-party agencies.

Another tool for information sharing is through various state and national associations. Partners such as the National Insurance Crime Bureau (NICB) have excellent systems set up for the appropriate sharing of information between insurance carriers and between insurance carriers and the public sector. While perhaps not having the same force or nationwide impact as NICB, organizations such as ICAC, the National Society of Professional Insurance Investigators, the International Association of Special Investigation Units, the Claims and Litigation Management Alliance, and the Coalition Against Insurance Fraud to name a few are all excellent avenues available to insurers to participate in and learn valuable information regarding the ongoing battle against fraudulent insurance claim activity.

Each of these organizations rely and depend on the financial and personnel support of insurance carriers, attorneys, and experts to play vital roles in the success of these associations and their ability to provide the vehicle for learning new information and identifying fraudulent insurance activities and individuals.

Since the prior publication of this book, there has also been a rapid explosion of Internet technology and the sharing of electronic information. Whether insurers want information shared on the Internet is no longer entirely under their control. Criminal defense attorneys, civil plaintiffs' attorneys, and related individuals and associations will frequently post information regarding insurance carriers and their claims practices and activities. Information garnered by insurance carriers in their investigation of insurance fraud may also find its way to the Internet either by dissemination of information to third parties or, as some companies have found out, by disgruntled employees who leave the employment of the insurance carrier and subsequently post damaging information on the Internet. Companies must be extremely cautious of this type of negative information sharing, and every insurer should consider that all internal communications, manuals, and documents may be disseminated electronically and used in court proceedings.

Certainly, there are many strategic advantages to electronic communications and the ability for insurers to investigate insurance fraud much more easily through Internet searches and the securing of documentation electronically, rather than having to travel great distances to personally secure the information. The Internet provides opportunities as well as risks and concerns that must be addressed in today's world of information sharing and the ongoing battle of fraudulent insurance activities and bad faith litigation.

In summation, insurance carriers should share information when appropriate and use state laws to their maximum benefit for the proper sharing of information both privately and publicly. Insurance fraud is best abated when it is out into the light of day rather than hidden in the darkness. It is in this way insurers ultimately prevail in bad faith litigation by showing the company truly had a good faith basis to investigate the underlying claim at issue. The ability for companies to share information with each other, to disseminate information to the public sector so appropriate investigation and prosecution are undertaken, and possibly to share information with a media audience will all aid in fighting fraud and protecting the legitimate policyholders to whom an absolute duty is owed to fight insurance fraud effectively at all levels.



## V. Legal Issues

### A. Introduction

No discussion of insurance good faith or the risk of bad faith can ignore the intersection of these concepts with litigation and the legal process. How insurers address a claim from the first notice may well affect the final decision of a judge or jury concerning whether the actions of the company were in good faith or bad faith. While each state's laws will differ concerning the legal standard for what may constitute the tort or claim of bad faith in an individual jurisdiction, in most situations the determination of what constitutes bad faith will still ultimately rest upon questions of reasonable justification, fairness, and what a court or jury may determine was acceptable during the claim investigation or adjustment process. Accordingly, an insurance carrier has an absolute duty first to its insureds, but equally to its employees, to make certain the company at all times has a thorough and complete understanding of the appropriate legal standards to conduct a good faith investigation. The company must also at all times not only adhere to, but far exceed, any type of minimum legal requirements of the jurisdiction in terms of avoiding bad faith in the handling of any claim or loss. This section explores myriad legal issues that affect the investigation and handling of insurance claims, which may result in potential exposure to the company for bad faith liability and damages.

It is important to know that an insurer's insurance policy at its very core is nothing more than a contract. Most jurisdictions view insurance contracts as contracts of adhesion, meaning they are one-sided contracts favoring the insurance carrier over the insured. For this reason, courts will strictly construe the terms and conditions of the insurance policy most strongly in favor of the insured or claimant and against the interest of the insurer. There is quite simply no excuse for an insurance claims professional not having a thorough and working knowledge of the insurance contract, including its terms, conditions, duties, exclusions, and limitations. In this era of an increasing number of claims being handled by an ever decreasing number of claims personnel, it is important adjusters and managers have accurate and correct information concerning the various policies that are placed into the marketplace and under which a claim may arise. In recent years, insurance carriers have also consolidated their claims operations into larger regional service centers, meaning adjusters and managers are responsible for multiple states or portions of the country and in each state the policy language may differ. Assuming an exclusion, duty, or limitation exists in a policy without verifying the actual language may well be the foundation for a substantial bad faith claim.

Insurers may also be held in bad faith when coverage decision letters are sent that fail to cite the correct section of the policy, cite a form policy that differs from the one actually sent to the insured, or where the language cited came from the basic policy without the adjuster or legal counsel realizing an endorsement changed or altered the policy language. Judges and juries are well justified in being angry with insurance carriers when the basic foundation of the bad faith claim is the insurer did not have a thorough and accurate understanding of its own contractual provisions in a policy that the insurer itself drafted.

### ***B. Consider Proper Use of Proofs of Loss***

While any insured or claimant is owed utmost courtesy, respect, and promptness from the immediate time a claim is reported to an agent, call center, or claims office, an insurance carrier, from a purely legal standpoint, does not have an actual claim presented until a proof of loss, if requested, is received from the insured. While no insurer will likely insist on a proof of loss for each claim, with a claim where insurance fraud or other coverage issues may be in question a proof of loss is a reasonable and necessary step and should be a condition and duty set forth in the policy. The reason the claim does not arise legally until the proof of loss is submitted is because that is the first time in accordance with the contractual terms the insured has been requested to state under oath the type of loss it sustained, where the loss occurred, and detail specifically the damages he/she is seeking under the insurance policy agreement.

While the proof of loss is an extremely valuable tool for insurance carriers, insurers should have a policy and procedure in place as to when it is appropriate for a proof of loss to be requested and make certain that policy is followed. If it can be shown the proof of loss is only being used on a selective basis or to “penalize” certain types of insureds this may be evidence of bad faith. Most states will not permit an insurance company to mandate its own proof of loss form be used if all of the information sought is provided by the insured or through a public adjuster but in a different format. Insurance companies also oftentimes make mistakes by rejecting proofs of loss because of the omission of information such as policy numbers when the insurer was just as capable in securing that information as the insured. Equally insurers oftentimes will accept proofs of loss that should have been properly rejected. Proper reasons for rejection may include the failure of all insureds (including husbands and wives) to sign the proof of loss or failure to provide meaningful responses and information such as the amount of loss or damage being claimed by simply stating improperly “undetermined” or “to be determined.”

### ***C. Proper Use of Examinations Under Oath***

Perhaps the best tool an insurer has to protect the company against bad faith is the Examination Under Oath (EUO) provision of the policy. Many judges and jurors would not understand how an insurance company reached a decision to deny coverage for a loss without the sworn testimony of the insured. Many insurance professionals agree that if an insured refuses to give a recorded statement concerning a loss then he/she has breached the policy under the provision of the “duty to cooperate.” While some insurers are changing their policies, most standard insurance contracts do not mandate recorded statements. An insurance carrier may well be held in bad faith when the claimant or his/her attorney asks the claims professional on cross-examination where in the policy is it mandated that the insured or claimant give a recorded statement. When it is then pointed out the insured or claimant had no such written duty and was willing to submit if requested to an EUO, but the insurance company was too cost conscious to conduct such an examination, there is little defense available to the employee or insurance company that is now a defendant in the pending litigation.

While EUO may be an extremely effective tool in protecting against bad faith by allowing the insured or claimant to tell his/her side of the story and explain all facts and circumstances, it is equally crucial the insurance carrier conduct the EUO with utmost good faith.

While it is important to check with individual state bar associations, supreme courts, and other governing bodies, many states will find the taking of an EUO by a non-attorney to be unauthorized practice of law. This has become a growing concern in the era of decreasing budgets and financial resources. Insurance carriers that engage in this



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practice may be exposing its employees to a possible civil or criminal penalty or facing a situation where if the issue is raised for the first time at trial the EUO may be stricken from the record as being improperly taken. While this issue may be debated, the reality is all judges, attorneys, and most jurors are going to view a cross-examination as being a legal function, and most insurance carriers are not going to be able to provide any justification for using a non-lawyer to cross-examine an insured or claimant other than simply wanting to save money. This does not present the insurance company in a good light or good faith situation in front of a judge and/or a jury.

Insurance carriers also must be much more cautious in selecting the counsel to take an EUO. The legal counsel who is excellent at defending the company on an auto bodily injury claim may have no idea how to conduct an EUO on a property loss. The sad reality is insurance defense lawyers who want to garner the support and more business from an insurance carrier will rarely tell the company they are not specifically skilled in taking an EUO. Attorneys who confuse a deposition with an EUO are in extreme peril to an insurance company and may lead the insurer directly into the path of bad faith.

Unlike a deposition that is automatically an adversarial proceeding where normally both sides are represented by counsel, litigation is pending, and one party will prevail in that litigation, an EUO should be non-adversarial, and its purpose is to secure accurate and factual information so the correct decision is made concerning the claim. Insurance carriers must understand that every word the attorney says in the EUO may well be used as the basis for a bad faith claim against the insurance company. While serving as legal counsel, the attorney is also operating as the agent of the insurance company in conducting the EUO. Overly aggressive questioning, irrelevant questioning, or stating information that may be misleading may be used directly against the insurance carrier as evidence of not conducting a good faith investigation of the claim or prejudging the claim prior to the completion of the investigation.

Some reference also must be made to the growing use of house counsel in taking an EUO. While house counsel is qualified to take testimony, insurance carriers should consider how a judge or jury may view an in-house attorney taking an EUO versus independent outside or panel counsel. There is certainly nothing directly unethical in most jurisdictions of using house counsel. It is important to check with the local state bar association, supreme court, or department of insurance regarding this issue. In terms of bad faith, insurance carriers should consider the arguments opposing counsel will make regarding the employment status of the attorney, his/her potential bias or prejudice, and the desire to secure bonuses or financial compensation through the insurance carrier as potential motives to not conduct the EUO fairly or properly.

The savings that could result by using in-house counsel may be lost very quickly when a multi-million dollar bad faith verdict is returned. There is nothing in this analysis that implies outside counsel is more qualified, knowledgeable, or has better skills than in-house counsel. The question insurers must consider in the totality of the claim investigation and possible ensuing litigation is what effect the use of outside counsel versus in-house counsel may have on a judge or jury that is ultimately deciding whether the company acted with utmost good faith in the handling of the claim investigation.

#### ***D. Innocent Insured/Spouse Doctrine***

Specific attention must be paid in each jurisdiction to what state law applies to an innocent co-insured or spouse even in cases where direct and substantial evidence exists of one insured committing fraud or an intentional act. Failure to consider what interest an innocent co-insured or spouse may have under the insurance contract can be direct evidence of bad faith.

While often the individual claims professional or investigator will be able to ascertain this information by virtue of a working knowledge of the individual state or jurisdictional laws, if there is any doubt it is crucial that a legal opinion either from house counsel or panel counsel be secured to properly address what duties, responsibilities, and payment (either in whole or in part) may be due and owing to an innocent co-insured or spouse based upon the specific facts and circumstances of the claim at issue.

### ***E. Reservations of Rights and Non-Waiver Agreements***

Another important tool for insurers is the proper use of reservation of rights letters and non-waiver agreements. It is important to understand these two documents are not synonymous or equal. A non-waiver agreement is generally a standard form signed very early after the loss occurs by the insured. The advantage is the non-waiver is a signed document, so there is no doubt it was received by the insured and ostensibly read by him/her. Unfortunately non-waiver agreements do not normally identify or contain specific information regarding the facts of the loss or what specific coverage or claim questions are being investigated.

In contrast, a reservation of rights letter under most state laws must be detailed and must specifically be sent to the insured notifying him/her of the exact issues and concerns identified by the insurance carrier that may affect his/her coverage under the policy. Such letters may even cite specific policy language at issue. Insurance employees who believe the purpose of the reservation of rights letter is to protect the company are viewing the use of a reservation of rights improperly. Instead of existing to protect the company, a well-written reservation of rights letter should fairly and unequivocally place the insured or claimant on notice as to what issues, problems, and concerns have been identified with the claim and what specific sections of the policy may be at issue in determining whether coverage is due and owing.

Failure to properly use a reservation of rights letter and/or non-waiver agreement may be evidence of bad faith and may lead to paying a claim for which coverage may never have been due and owing. It is equally necessary to understand the importance of a well-written reservation of rights letter, as one that contains inaccurate or false information may be evidence of bad faith while a balanced and fair reservation of rights may be the company's best evidence of showing from the start how the claim investigation was handled with utmost good faith.

One final point for insurers to consider is each reservation of rights is not to be issued unilaterally, but as a mutual reservation of rights. Simply changing the language ever so slightly, it is important to note to the insured or claimant the company is reserving its rights, but also recognizing fully all rights and interest under the policy of the insured or claimant are equally protected and reserved to the insured's or claimant's interests as well.

### ***F. Authorizations***

While the insurance contract contains broad parameters concerning the duties and responsibilities of an insured in the event of a loss, most policies are silent regarding specific duties, including allowing access to inspect and test property or providing bank records, credit card statements, tax returns, cellular phone records, and other relevant data. In most situations, the policy will not directly address these issues, but a well-drafted claims authorization should.

Many insurance carriers are updating their claims authorization forms in the world of electronic and Internet communications to include a much broader array and request for information, such as social media data, cellular phone, laptop and tablet information, and other sources of electronic communications and data. Using outdated authorizations may well be viewed by a jury or judge as acting in bad faith if the authorization does not clearly spell out what uses and purposes the insurance company is requesting data for or the type of data being sought. Many companies make the mistake of relying on authorizations that may be a decade or more old, simply not keeping up with the changing times.

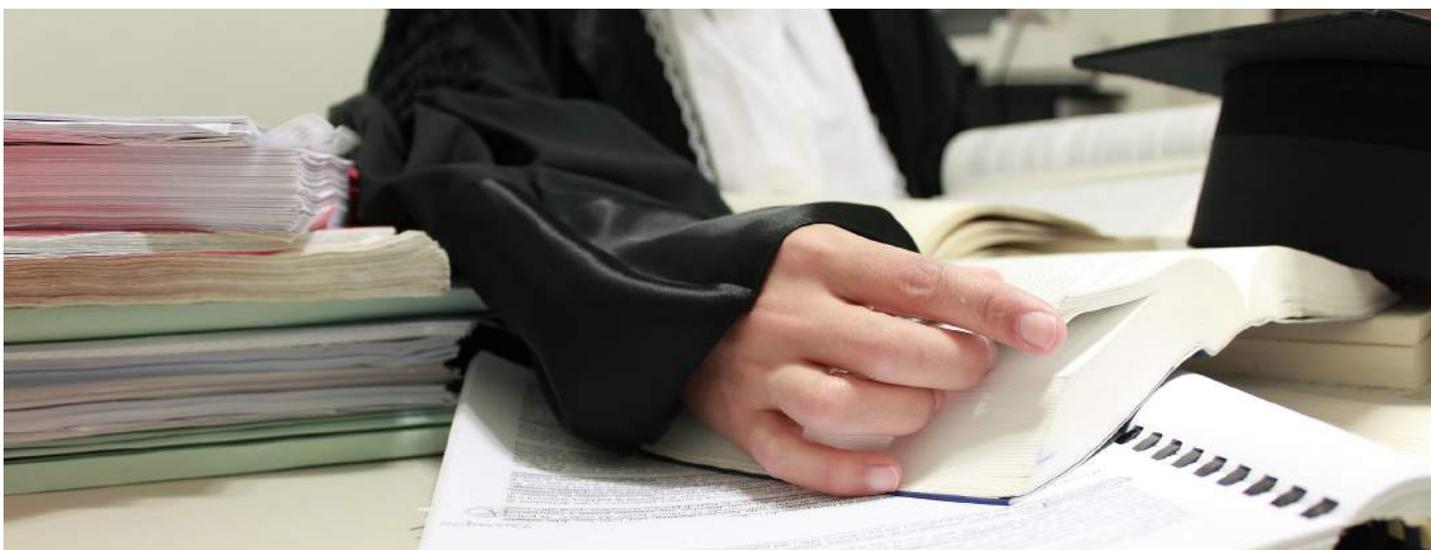
A well-drafted and signed authorization should provide an excellent basis for an insurance carrier to proceed forward with a good faith investigation of any loss. Failure to consider from whom an authorization is necessary may also be evidence of bad faith, such as having one spouse sign an authorization. Failing to ensure that the person who signs on behalf of the corporate insured has binding authorization from the corporation to do so may be a basis to find a company in bad faith. Both scenarios could in a subsequent trial lead to the elimination of the ability to introduce information or documentation improperly secured with an authorization either not signed by all insureds or not appropriately executed.



### **G. Knowledge of NFPA and Other Guides or Standards**

The purpose of this publication is not to debate the content of NFPA 921 or other similar guides or standards relied upon in the handling and investigation of insurance claims. There is significant debate underway currently with myriad changes to NFPA 921, so it is crucial for insurance carriers, their employees, experts, and attorneys to stay up-to-date and current on all new developments with NFPA 921 and other such guides and/or standards.

One of the issues insurance carriers will continue to face is whether eliminating all other possible sources for the ignition of a fire, other than an intentional human act (i.e. negative corpus), is admissible and proper either under NFPA 921 or state law. As part of the vetting process in hiring experts, it is crucial that an insurance carrier make certain any origin and cause investigator hired knows both the jurisdictional laws and the most current provisions of NFPA 921. Failure to do so may not only render the expert's finding inadmissible, but also may be evidence of bad faith by the insurance carrier. Insurance carriers should have a frank and honest discussion with approved and vetted origin and cause experts as to the issue of negative corpus in their particular jurisdiction, the views of the origin and cause expert, and how, if such an opinion is admissible, he/she will address an elimination of the all-other-sources argument when faced with cross-examination in a deposition or jury trial.



### **H. Extra-Contractual Exposure**

In addition to insurers being at a higher risk than at any point in history for bad faith exposure, there is also myriad new potential for bad-faith-style claims, which may arise from even routine insurance claim investigations. Aggressive plaintiffs' attorneys seeking to prove to a jury an insurance company acted in bad faith are turning to legal theories, including defamation, such as the dissemination of information implicating the insured in a fraudulent activity or misrepresentation to third parties; trespass, where a proper claims authorization to enter upon premises has not been signed by the appropriate or all insureds; or intentional or negligent infliction of emotional distress for an incorrect claim decision, as being new elements of recoverable damages or tort actions.

Both insurance carriers and their retained SIU counsel must be fully aware of these new theories being argued and be vigilant in taking all appropriate actions to guard the company at each step of the investigation process from any potential argument or claim being alleged down the road. Acting with utmost good faith means an insurance carrier is cautious in whom information is disseminated; only takes steps in the investigation of the claim as authorized by the policy terms and conditions or an appropriately signed authorization; and ensures the decision made on the claim is made not only with reasonable justification but with making sure the facts – scientific and other evidence –

support the decision; and that a correct and informed decision was made concerning the claim. Making certain these steps are followed with every claim is one of the best protections a company can have against an unfounded bad faith claim subsequently being asserted.

Another major issue affecting insurance carriers centers on spoliation of evidence. An insurance carrier may become victim to spoliation of evidence, either in defending a claim or attempting to prosecute a subrogation claim, even at the time the scene is released from the public-sector investigators to the property owner or insurer. Building strong ties between public-sector investigators and private-sector origin and cause and insurance professionals is key in making certain evidence is preserved, inspected, and tested as promptly after a loss as possible.

Insurance carriers can equally commit spoliation of evidence without actually intending to do so. An origin and cause investigator who does not have a full understanding of the legal implications of moving or altering evidence before placing potentially responsible parties on notice may literally cost an insurance carrier hundreds of thousands or millions of dollars. Insurance carriers that fail to properly investigate and preserve a fire loss or other insurance loss scene may equally find a challenge asserted in civil litigation that evidence was spoliated. Spoliation of evidence in a jury trial may be a serious issue that, according to the state jurisdiction, may permit a judge to enter judgment against the party who spoliated the evidence or instruct the jury in a manner highly prejudicial to the party who destroyed or altered the evidence by implying had the evidence been properly secured, it would have proven the other side's defense in full. It is absolutely crucial every insurance investigator and retained expert have a thorough and working knowledge of the concept of spoliation of evidence and the serious impact it may have during the course of a claim investigation.

### ***I. The Arson Triangle***

Many people working in the insurance profession today have been trained on the concept of “means, motive, and opportunity” as the foundation for the arson triangle. In truth, this concept is the foundation for any type of insurance fraud investigation, as bodily injury or a fire loss must be proven by the means (how the loss occurred), the opportunity (the claimant being in a position to have been involved in or a part of the loss), and the financial motive of insurance recovery.

Across the United States, judges are acquainted with the concept of means, motive, and opportunity, and it is certainly fair game for an opposing attorney to question any claims professional, SIU investigator, or expert concerning what evidence was developed to support each appropriate prong of the triangle.

While each prong must be proven and is normally viewed as being equal in the aftermath of the 2008 economic collapse, it is also important to consider that in all probability the concept of motive to commit insurance fraud, either through arson or other intentional acts, has perhaps never been easier. Jurors today fully understand factors such as unemployment, foreclosures, and lack of credit that may give rise to the financial motive for a person to commit an act of arson or insurance fraud. Nevertheless, it is always important for insurers to understand the burden of proof for all aspects of the arson or insurance fraud triangle rests solely and exclusively on the insurer to prove in court when a coverage decision leads to a denial of coverage for what otherwise may be a covered loss.

### ***J. Retention of Legal Counsel***

Each insurer will need to make its own decision concerning at what point in a claim investigation legal counsel should be consulted and involved in the loss. Carriers will also need to make the decision, as briefly discussed earlier, concerning whether it is appropriate to use house counsel or outside independent panel counsel to assist in a claim investigation or coverage decision. These are important decisions to make, and the vetting and approval of the appropriate counsel to assist in the claim investigation are equally if not more important than the selection of the correct origin and cause or other independent investigator.



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It is equally crucial attorneys understand that their role in the investigation is to gather correct and accurate information, and, if coverage is due and owing, to notify the carrier promptly to proceed with payment of the claim. If the attorney views his/her role in the claim investigation as trying to find a way for the insurance company to not pay the claim, then the company is operating in bad faith. To the contrary, the attorney should be the independent analyzer who advises the insurance company concerning the laws appropriate to the jurisdiction, and, based upon those laws and the information contained in the investigation, guides the company on the correct decision as to whether coverage should be extended or denied.

There are decisions reported throughout the United States where if legal counsel is shown to actually be adjusting or handling the claim in place of the insurance professional, there is no attorney-client privilege extended and the entire file of the attorney may be open to discovery, and the attorney may be subject to full deposition or cross-examination. Both the attorney and the insurance company are equally charged with the responsibility to make certain the role of the attorney is clearly defined as providing independent legal analysis and guidance, and not as a replacement for adjusting the claim in an attempt to hide information or documentation under a claim of legal or attorney-client privilege.

When done properly, the role of the attorney should be to assist, guide, and protect the insurance carrier. The best service the attorney can provide in achieving that goal is to be the gatekeeper to make certain at all times the interests of the policyholder, insured, or claimant are being fully and completely protected in accordance with the policy terms, conditions, coverages, and applicable state law. In tandem with selecting the appropriate legal counsel, it is also important the insurance carrier and legal counsel maintain appropriate and proper lines of communication at all times. Issues concerning whether expert reports should be sent directly to the carrier or through counsel are appropriate for consideration, depending upon the facts and circumstances of the loss and the appropriate rules and laws of the jurisdiction. While there may be valid reasons for certain communications to be sent to legal counsel for the protection of work product or privilege, this should be viewed with caution, as if it is ultimately determined the reports or information are discoverable, a jury or judge may find the actions of the insurance company in trying to withhold or hide the information through the attorney work product or privilege exclusion to be an act of bad faith. These types of decisions should be made on claim-by-claim basis and only after careful discussion and consideration in fairness to everyone involved, including the policyholder or claimant, before a decision is made concerning trying to protect information under an attorney work product or privilege protection.

### ***K. Payment of Undisputed Damages***

There will be times in a claim investigation when a portion of damages is due and owing to a named insured, mortgagee or lienholder, or other party, while remaining damages are in controversy concerning the extent or amount or to whom payment is owed.

To protect insurers from potential claims of bad faith, it is important once coverage is determined to be due and owing on all or a portion of the claim, payment is made as promptly as possible. Insurance companies may be held liable for bad faith damages if the carrier admits payment was due and owing to one or more insured parties under the contract but failed to make timely payment while other portions of the claim remained under investigation or other amounts remained in controversy. Withholding payment on any portion of a claim or to any insured where an insurance carrier reasonably owes coverage, depending upon the jurisdictional laws, may constitute bad faith.

There has been an increasing number of insurance bad faith claims filed where even though payment on the claim has been made, the allegation of bad faith is the insured took too long to issue payment or delayed payment because the carrier did not have a good faith basis for the investigation to have occurred or to proceed.

To protect against potential claims of this nature for bad faith, insurance carriers should have education and training programs in place for all levels of the claim and SIU investigation teams. The issue of prompt payment for undisputed damages needs to be addressed in full, and specific policies and procedures must be in place to make certain those payments are issued in a timely and prompt manner.

When in doubt concerning these type of issues, it is also appropriate to seek the advice and direction of either house counsel or independent outside panel counsel, depending on the method of securing legal representation used by an individual insurance carrier.

### ***L. Rights of Mortgagees***

Most states recognize what is called the New York standard insurance clause, which may give rise to an insurance carrier's duty to pay a mortgagee or lienholder even if the insured intentionally destroyed the property or committed insurance fraud. Courts have recognized this separate duty as creating a contract within the contract whereby there exists differing duties and responsibilities to the lienholder, requiring the insurance carrier to issue payment even if payment is not properly due and owing to the policyholder or named insured.

In many jurisdictions, the mortgage company or lienholder may have the right to pursue a bad faith action against the insurance carrier, as would any other named insured or party to the contract. Failure to properly assess and have a working knowledge of the duties and responsibilities owed to mortgage companies and lienholders in a particular jurisdiction may expose an insurance carrier to a claim of bad faith by one of these entities.

Whether handled through the claim and SIU training process or seeking the advice of either in-house attorneys or outside independent panel counsel, it is imperative to address on each claim the rights, duties, and responsibilities owed to mortgage holders and lienholders as part of the claim adjustment process.

Keep in mind that an insurance carrier may still operate in good faith by paying a lienholder and taking back either an assignment of the mortgage or the right to collect back against a named insured who acted fraudulently, or with intent in damaging or destroying a property, to protect its right to seek restitution. In these instances, it is important to identify this early on as an issue with the mortgage company or lienholder and secure an appropriate agreement in writing, but equally make certain the payment to the lienholder or mortgage company is not made necessarily contingent upon it providing assistance and cooperation in securing repayment from the responsible party.

### ***M. Bankruptcy and Its Implications***

Insurance carriers faced with a bankruptcy filing either by a named insured or lienholder face new pitfalls and perils. Once a bankruptcy proceeding is filed, the named insured or lienholder may no longer have true ownership of the claim, and any rights under the policy may be assigned to the court or the bankruptcy trustee.

Insurers that fail to consider the impact and ramifications of a bankruptcy filing and proceed to issue payment either in ignorance or with knowledge of the bankruptcy filing may do so at their peril, potentially not only acting in bad faith but having to pay the claim and damages more than once.

Bankruptcy is normally going to be controlled under the federal court system, and it is important to conduct docket checks, ask appropriate questions in recorded statements and EUO, and make certain the company has investigated fully whether a bankruptcy filing or petition may have an impact on a pending claim or loss. Information may also be appropriately secured in good faith from bankruptcy filings, which may be relevant in determining the value of contents or even a structure, as bankruptcy schedules require the filing party to truthfully and accurately state all assets and their value. As these are public record documents, an insurer may in good faith secure this information. In some states, an insured may even be barred from subsequently claiming an amount in an insurance loss above the amount claimed in the bankruptcy court filing.



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Insurance carriers, directly or through their legal counsel, should not only investigate whether a bankruptcy filing may have direct relevance to the pending claim but should also open up a written line of communication with the bankruptcy trustee, remembering the trustee may have the same duties as the named insured to submit proper and adequate information, documentation, proofs of loss, and other relevant information to assist the insurer in assessing the amount of loss and whether coverage is due and owing.

Finally, when in doubt an insurance carrier may need to request clarification from the bankruptcy court as to what amount is due and owing and who is the legal entity or person entitled to recover proceeds under the policy. It is important to note for purposes of protecting the company from bad faith that even a routine claim with no evidence of intentional acts or insurance fraud may also be fraught with peril where a bankruptcy filing has occurred and the insurance carrier has not properly assessed to whom and under what circumstances payment may be due and owing.

### ***N. Impact of Foreclosure***

Today, more American homes and properties are in foreclosure than at any point in modern history. The effect of the 2008 economic collapse continues to reverberate throughout the American economy, and while the rate of foreclosure has slowed, foreclosures will continue to be a factor for many years to come.

Insurers must be very cautious in analyzing the issue of foreclosure both as a potential motive for a person to burn or damage property and to determine to whom coverage may be due and owing even when an intentional act of insurance fraud has occurred. As was addressed previously, mortgage companies often have separate and distinguishable rights even when coverage may not be due and owing to the named insured.

Acting with utmost good faith also requires an insurance company to properly investigate a claim to determine whether a property is actually in foreclosure or may fall into foreclosure between the time the loss occurs and when the coverage decision is issued. Failure to properly monitor court dockets and other information concerning a foreclosure action may place an insurance carrier in a position of being liable for bad faith damages. Claims professionals and insurance investigators need to be very cautious and have a strong working understanding of what it means for a property to be in foreclosure. Claims may be handled in bad faith when a company believes the insured misrepresented the facts and denies coverage because the insured advised the property was not in foreclosure in a recorded statement or EUO, but the carrier had in its possession a number of delinquency and notice to vacate letters sent to the named insured.

A foreclosure proceeding is an actual judicial complaint filed in most jurisdictions in the county where the property is located whereby the mortgage holder seeks to actually foreclose on the property for non-payment of the mortgage. Insurance professionals, investigators, and attorneys must know to ask the correct questions about whether a property is actually in foreclosure, such as has an actual complaint for foreclosure been filed with the court or whether the mortgage is delinquent and the mortgage company may be planning to file for foreclosure at some point in the future. Making the mistake of jumping to the conclusion of foreclosure merely because a payment is delinquent or foreclosure has been threatened may lead the insurance carrier to improperly issue or deny payment or base a decision on inaccurate information. Incorrect analysis of mortgage foreclosure proceedings may place the company at risk for a potential bad faith judgment.

### ***O. Role of the Public Adjuster***

Most states will allow a public adjuster to assist an insured or claimant if the adjuster is properly licensed in the jurisdiction. The role of a public adjuster should be to assist the insured in making certain the claim is submitted in accordance with the policy terms and conditions and to facilitate a proper and open line of communication between the insured/claimant and the insurance carrier. Reality, however, often differs from this ideal. There are myriad reasons as to why oftentimes the relationship between insurers and public adjusters is less than ideal, and there is often plenty of blame to go around on both sides.

It is imperative for both the insurance company and the public adjuster to treat each other with utmost courtesy, professionalism, and respect. Bringing past grudges or histories from prior dealings or claims may not only lead to a potential claim of bad faith, but also may open up a history of claims files for discovery in bad faith litigation.

An insurer wanting to act in utmost good faith should treat a public adjuster in the same manner as the named insured or policyholder. Communications should be polite, informative, and timely. The terms and conditions of the insurance policy should be spelled out in writing and if any exclusion or other limitations of the policy are being invoked, it should be done so in writing and in a timely and clear manner.

It is also important to understand the role of the public adjuster is specifically defined and limited by each state's applicable law. Depending on the individual jurisdiction, the role of the public adjuster may be specifically limited in what he/she may be able to do. In no jurisdiction is the public adjuster recognized in the same manner as an attorney or legal counsel. Each company will have to make its own decision in accordance with the state bar association, supreme court, or other laws and regulations, but often times a public adjuster does not have the right to attend an EUO or to counsel or guide the witness during the course of taking EUO testimony. This is not an issue, however, that should be addressed in an argumentative manner for the first time at the EUO. Well-vetted and well-trained attorneys who take EUO should know the law of the jurisdiction in advance of whether a public adjuster is permitted to attend, and if so what the scope or role may be at an EUO or other similar proceedings. If it is known this is going to be an issue prior to the EUO, legal counsel should direct correspondence appropriately to the public adjuster notifying him/her in advance of the company's position and the applicable law or regulation that limits the role of the public adjuster.

It is also imperative to keep in mind hiring a public adjuster does not change or alter any of the terms, conditions, duties, or responsibilities outlined in the contract of insurance. A public adjuster who unduly interferes or blocks appropriate lines of communication or cooperation in the claims adjustment process should be held accountable. The correct manner is to notify the named insured or policyholder of the issues that have arisen and request his/her assistance and cooperation. Such letters should be directed equally to the public adjuster and to the policyholder or claimant. If the issue is not capable of being amicably resolved, an insurer should seek involvement of an outside mediator or third party. An insurer could also notify the state department of insurance or other appropriate entities responsible for licensure of public adjusters – whether to notify them of an infraction or to seek any assistance they can offer the company in handling the claim in a good faith manner and securing the information necessary to make an informed and correct decision.

### ***P. Limiting the Exposure for Institutional Bad Faith***

As the field of bad faith litigation has become more contentious and the financial recovery in bad faith verdicts has risen, attorneys have been more aggressive in trying to seek higher levels of damages, especially in the field of punitive damages, against insurance carriers.

One of the avenues attorneys have used is to claim an institutional or corporate-wide policy of bad faith rather than simply an individual claim. Court decisions across the country have been favorable to insurers in normally limiting evidence of bad faith to an individual claim decision and not opening up overly wide discovery on a multi-state or national level to unfounded claims of institutional bad faith. This should not be viewed, however, by insurers as a license or ability to engage in such practices, and they should be prohibited and banned at all levels from local claims operations to national policies and procedures.



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Whether on an individual claim or across the geographic territory an insurance carrier writes policies, all claims should be handled with utmost professionalism and in strict accordance with the policy terms and conditions. All claims where coverage is due and owing should be paid in full and paid promptly. Carriers that fail to adhere to these clear standards of good faith will subject themselves to not only individualized claims of bad faith, but also to claims of a wider geographic or national scope of institutionalized bad faith practices. There are both state and federal judges who are amenable to such institutionalized bad faith allegations by opposing counsel where there is any such evidence of pattern and practice activity engaged in by insurers.

Insurance companies run the risk of having published guidelines and standards for the handling of claims used against them in jurisdictions, but they run the same risk when they don't have written guidelines or standards. This is truly a situation where the carrier is faced with the decision to either publish guidelines and be criticized for doing so, or not publish any guidelines and be equally criticized for failing to do so.

Insurance carriers should have in place policies and procedures of which they should be proud to have evidenced to any judge or jury that outline issues such as fairness, thorough and accurate investigation, and prompt payment of all coverage due and owing. Carriers equally can help avoid claims of institutionalized bad faith by making sure appropriate and positive training programs are in place to ensure these standards and guidelines are followed in the handling and investigation of claims no matter where the loss may have occurred geographically.

## VI. Discovery Issues Relating to Bad Faith

### A. *Electronic Discovery*

Electronic communication and document retention are at the heart of the modern insurance business. From the field adjuster with a laptop and a smartphone to the home office personnel with computers, massive amounts of electronic data are generated each year.

An attorney prosecuting a bad faith claim may try to seek production of paper and electronic copies of documents. Assuming the attorney's demand is legally valid, this request could impose a large burden on the company. What if the document was emailed to individuals, with a request to comment and make revisions? If the document was saved in a central location and edited there, does the company have to search all its backup for the period of time and retrieve every copy of that document appearing wherever it appears in backup sources so as to capture all the revisions? What if the information contained in back up files is inaccessible because the software to read the information no longer exists? And, most importantly, who manages and pays for all of this?

Companies can control rising data costs with automatic record deletion/retention programs, which can be customized to delete specific data after a certain amount of time (e.g., emails) and permanently archive other data. Some applications, such as text messaging applications, might automatically delete data to make room for new data.

Ascertaining the full array of electronic/digital company information and communications is of great importance to any company in modern discovery practice.<sup>20</sup> Having this knowledge is crucial when the company is placed under a statutory or common law duty to preserve electronic communications because litigation is anticipated. This preservation is then communicated to key individuals involved in the matter, a communication commonly known as a "litigation hold."<sup>21</sup>

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<sup>20</sup> R & R Sails, Inc. v. Ins. Co. of the State of Pennsylvania, 251 F.R.D. 520 (S.D. Cal. 2008 ) (sanctioning insurance company for failing to make "reasonable inquiry" as to whether it had electronic records responsive to the opposing party's request).

<sup>21</sup> The failure to communicate the litigation hold to individuals involved in the matter can constitute gross negligence. Rebecca N. Shwayri, Preserving the Needle in the Electronic Haystack: Proposed Federal Rule Amendments and Their Impact on E-Discovery, 38 J. Legis. 118, 120 (2012).

When under such a preservation duty, failing to suspend the programs of deleting data could result in severe sanctions if electronic data related to the claim and necessary to the lawsuit are later deleted and forever lost.<sup>22</sup> Knowing when the company is under a preservation duty, however, is not always an easy task because such a duty arises when litigation is reasonably anticipated.<sup>23</sup> Therefore, the mere receipt of an insurance claim (ultimately morphing into a bad faith claim) does not necessarily translate into a preservation duty.<sup>24</sup>

The company's duty rises when the company "concludes [in good faith and through a reasonable evaluation] . . . based on credible facts and circumstances, that litigation or a government inquiry is probable."<sup>26</sup> The company must reach this conclusion through "a reasoned analysis of the available facts and circumstances."<sup>27</sup> In federal court, the general term "documents" includes "electronic data compilations."<sup>27</sup> At the outset of the litigation, the parties must meet at a discovery planning conference and consider electronic discovery issues facing both parties.<sup>28</sup> Here, the company should contemplate the electronic data it might wish to obtain from the opposing party. Following an electronic data request, the company must make a "reasonable inquiry" to determine if those documents exist in physical and/or electronic format(s).<sup>29</sup> This reasonable inquiry can be a very long, expensive process, especially if the scope of the document request is large. Who bears this cost can therefore be a heated issue in the litigation.

In discovery practice, the party responding typically bears the financial burden of responding to the discovery request.<sup>30</sup> Electronic discovery costs are typically higher than other forms of discovery and may reach into the hundreds of thousands of dollars.<sup>31</sup> But, where the cost of responding is very high compared to the potential information to be gained, the responding party may move for a court order requiring the requesting party to pay some of the production expenses.<sup>32</sup> Where the cost involves restoring archived data into a format that can be reviewed to determine if it is responsive to the request, a court may order restoration of a representative sample and order the responding party to bear that expense.<sup>33</sup> If the restoration of the representative data yields discoverable information, a court may order the responding party to restore the remaining data and require the requesting party to bear some of that expense.<sup>34</sup>

Once the information is retrieved, it must be produced in a "reasonably usable form," which may not be in the same form it was kept.<sup>35</sup> Production of the data in the same form in which it was kept ("native form") often may yield greater information about the data than if the data was converted into a more production-friendly form.<sup>36</sup> But, the parties may agree to or a court may order the production of the data in a converted form, such as a .tif or .pdf, that would allow for document control concerns such as confidentiality or easy identification (i.e., Bates stamping).<sup>37</sup>

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<sup>22</sup> *Id.* at 118.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 121.

<sup>25</sup> *Id.* at 122 (quoting The Sedona Conference, Commentary on Legal Holds: The Trigger & The Process, 11 Sedona Conf. J. 265, 272) (internal quotation marks omitted).

<sup>26</sup> *Id.*

<sup>27</sup> R & R Sails, 251 F.R.D. at 524.

<sup>28</sup> RLI Ins. Co. v. Indian River School Dist., No. 04-858-JJF, 2007 WL 3112417, at \*2 (D.Del. 2007).

<sup>29</sup> R & R Sails, 251 F.R.D. at 525.

<sup>30</sup> Zubulake v. UBS Warburg LLC, 217 F.R.D. 309, 316 (S.D.N.Y. 2003) (Zubulake I).

<sup>31</sup> Jacqueline Hoelting, Skin in the Game: Litigation Incentives Changing as Courts Embrace a "Loser Pays" Rule for E-Discovery Costs, 60 Clev. St. L. Rev. 1103, 1110 (2013); See Zubulake I, 217 F.R.D. at 312 (approximate cost \$175,000).

<sup>32</sup> Zubulake I at 316.

<sup>33</sup> See, e.g., Zubulake I.

<sup>34</sup> See Zubulake v. UBS Warburg LLC, 229 F.R.D. 422, 426 (S.D.N.Y. 2004) (Zubulake V).

<sup>35</sup> Seabron v. Am. Family Ins. Co., 862 F. Supp. 2d 1149, 1160 (D. Colo. 2012).

<sup>36</sup> *Id.* at 1160-61.

<sup>37</sup> *Id.*



Should the company prevail on its bad faith claim and is entitled to reimbursement of its fees and costs, a court may include the electronic discovery costs in that award.<sup>38</sup> Depending on the court, reimbursement may be for most of the electronic discovery costs incurred, or reimbursement may be for “only the cost incurred in copying [the electronic discovery].”<sup>39</sup>

## **B. Social Media**

Social media, such as Facebook, Twitter, and LinkedIn, present special issues for insurance companies. If used incorrectly in the investigation of the underlying claim, the misuse often will be a critical element of an underlying bad faith claim. If used ethically, it can be a key investigative tool to uncover and fight fraudulent claims.

Where the information on a social media account is public, it is generally acceptable to view the public postings. Where the subject has connections to friends, viewing the public profiles of the subject’s friends may also yield information that helps the investigator uncover fraudulent activity. Just like credit card records may yield important information regarding the insured’s location on the day of a fire loss, so too might the photographs the insured, the insured’s significant other, or the insured’s friends post on Facebook.<sup>40</sup> In location-based social media where the insured checks in at visited places, such information might be used to counter the insured’s version of the events leading up to a fire loss.



Postings can be deleted or shielded behind a privacy setting. Preserving the results of an investigation is of utmost importance, especially if the claim is denied and a bad faith claim is later brought. Preserved social media evidence is arguably more preferred than social media evidence that may be discoverable in litigation. If the preserved social media evidence indicates a fraudulent claim, the company’s attorneys could use this evidence to obtain discovery of all the insured’s social media.<sup>41</sup> Date/time-stamped printouts are a classic way of archiving such information.

<sup>38</sup> Hoelting, 60 Clev. St. L. Rev. at 1106.

<sup>39</sup> Id.

<sup>40</sup> Parks T. Chastain, Insurance Fraud: Prevention, Investigation, and Defense, Aspatore, 2011 WL 6749909, at \*15 (2011).

<sup>41</sup> See Keller v. Nat’l Farmers Union Prop. & Cas. Co., No. 12-72-N-DLA-JCL, 2013 WL 27731, at \*4 (D. Mont. Jan. 2, 2013) (must “make[] a threshold showing that publicly available [social media] information . . . undermines the [insured’s] claims.”).

Additionally, programs such as Adobe Acrobat Professional can capture websites with a date/time stamp documenting the capture. While use of the Internet Archive's Wayback Machine as an archiving tool can be useful in discovering earlier versions of the social media profile before it was deleted or shielded behind a privacy wall, admitting such evidence in court could be cumbersome and expensive.<sup>42</sup>

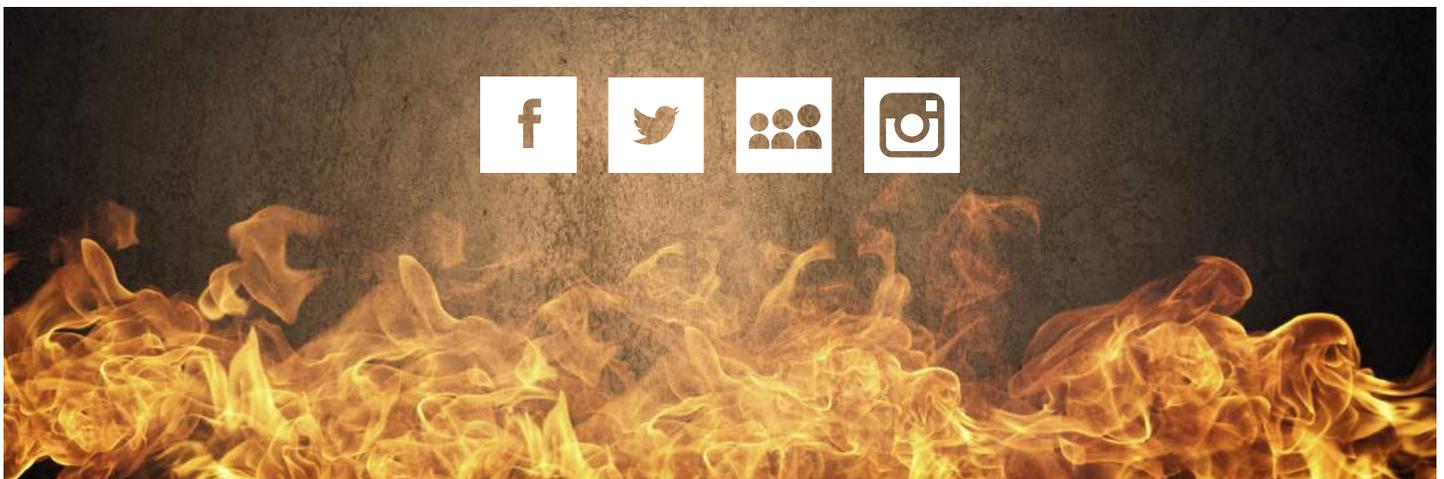
Where the fraudster has an understanding of privacy settings, he/she can shield this social media information from the company and its attorneys. Whether damning information exists behind these walls is unknown, and the investigator can understandably be curious. When the claim is in litigation, a subpoena to the social media providers is unlikely to yield information concerning the insured's postings and activities.<sup>43</sup>

In attempting to gain information behind a social media privacy setting, the investigator should use discretion and, at all times, avoid deception.<sup>44</sup> Generally there is nothing wrong with attempting to connect with the insured or the insured's friends using an honest business or personal account of the investigator.<sup>45</sup> Company personnel and agents should always avoid creating a fake social media profile/account in the name of a person familiar with the insured or the insured's friends, using this account to access private information (or using a third party to do this). Such misuse of social media is one of the surest ways to generate a bad faith claim.

### ***Investigating Arson and Fraud Through Social Media – Kathleen Romano v. Steelcase Inc. and Educational & Institutional Cooperative Services, Inc.***<sup>46</sup>

It should come as no surprise that many insurers are examining social networking websites in tandem with their investigation of insurance claims. In fact, several cases of insurance fraud have been uncovered, surprisingly, because people posted information to their Facebook or MySpace profile that supplied proof of fraud. Apparently these individuals never expected that their social media accounts would be targeted as a possible source for information. In other cases, people were of the mistaken belief that the security settings on their social media accounts would bar anyone from being able to view the content without their permission.

The question becomes, under what circumstances will a court permit someone to gain entry into a person's social networking account without his/her permission? While many courts are playing catch up on this techno-legal question, a few states have addressed this issue. And, a case out of New York helps to offer some guidance.



<sup>42</sup> See, e.g., *St. Luke's Cataract and Laser Inst., P.A. v. Sanderson*, No. 8:06-CV-223-T-MSS, 2006 WL 1320242 (M.D. Fla. May 12, 2006) (requiring the testimony of an Internet Archive corporate representative for the admission of such evidence).

<sup>43</sup> See Chastain, 2011 WL 6749909, at \*15 (describing Stored Communications Act).

<sup>44</sup> *Id.* at \*\*17-18.

<sup>45</sup> *Id.*

<sup>46</sup> *Investigating Arson and Fraud Through Social Media – Kathleen Romano v. Steelcase Inc. and Educational & Institutional Cooperative Services, Inc.* Supreme Court of New York, Suffolk County – 2010 NY Slip Op 20388; 30 Misc. 3d 426; 907 N.Y.S.2d 650; 2010 N.Y. Misc. LEXIS 4538.



In that case, Kathleen Romano claimed that she incurred permanent injuries when she fell off a chair that had allegedly been manufactured and distributed by the defendants. As a result of the fall, she claimed to have suffered restricted movement in her neck and back, pain, and progressive deterioration, injuries that affected her enjoyment of life, which she claimed caused her to be confined to her home.

At the same time, however, Romano’s Facebook profile page showed her smiling in a photograph outside the confines of her home. In addition, both her Facebook and MySpace pages suggested that she had an active lifestyle and had traveled to Florida and Pennsylvania during the same period that her injuries supposedly precluded such activities.

In light of these discrepancies, Steelcase deposed Romano and attempted to question her about the content of her social media accounts, but to no avail. Following her deposition, Steelcase served her with discovery that requested, among other things, authorization to obtain full access to her Facebook and MySpace accounts. Steelcase also issued subpoenas to both providers, but Facebook objected on the basis that it couldn’t release a person’s profile information without that person’s consent.

Allegedly, Romano refused consent to the release of any content contained in her social media accounts, and she filed a motion to quash the subpoenas on several privacy-related grounds. Therefore, Steelcase filed a motion seeking access to her current and historical Facebook and MySpace pages and accounts, including all deleted pages and related information on the grounds that the public portions of these sites reflected material that was contrary to her alleged injuries and deposition testimony, and on the grounds that the private portions of these sites likely contained evidence that was material and relevant to the insurer’s defense of her claims. Steelcase argued that preventing access to her private postings would be in direct conflict with New York law that states “there shall be full disclosure of all non-privileged matter which is material and necessary to the defense or prosecution of an action.”

Romano responded by asserting her constitutional right to privacy. However, the court noted that the Fourth Amendment’s right to privacy protects people not places. Thus, what a person knowingly exposes to the public is not a subject of Fourth Amendment protection. Notwithstanding, the court further noted that in order to determine whether a right to privacy exists, a reasonableness standard must generally be applied.

### ***Neither Facebook Nor MySpace Guarantees Complete Privacy***

It is interesting to note that Facebook does not guarantee complete privacy (and neither did the now defunct MySpace). For example, MySpace warned users that their profiles are public places; and Facebook’s privacy policy states:



When you use Facebook, certain information you post or share with third parties (e.g., a friend or someone in your network), such as personal information, comments, messages, photo, videos ... may be shared with others in accordance with the privacy settings you select. All such sharing of information is done at your own risk. Please keep in mind that if you disclose personal information in your profile or when posting comments, messages, photos, videos, marketplace listing or other items, this information may become publicly available.

\* \* \* \* \*

Although we allow you to set privacy options that limit access to your pages, please be aware that no security measures are perfect or impenetrable.

On that basis, the court held that when Romano created her Facebook and MySpace accounts, she arguably consented to the fact that her personal information would possibly be shared with others, notwithstanding her privacy settings; and that this is the very nature and purpose of these social networking sites or else they would cease to exist. The court further held that Steelcase's need for access to the information outweighed any privacy concerns that may be voiced by Romano.



To permit a party claiming very substantial damages for loss of enjoyment of life to hide behind self-set privacy controls on a website, the primary purpose of which is to enable people to share information about how they lead their social lives, risks depriving the opposite party of access to material that may be relevant to ensuring a fair trial.

### ***'Fishing Expeditions' Into a Person's Social Network Account is Not Allowed***

Few courts have addressed the issue of whether a person has a right to privacy regarding information they post on social media such as Facebook. However, it is interesting to examine decisions that have analyzed this issue. For example, a Canadian court's ruling in *Bishop v. Minichiello*<sup>47</sup> held that the hard drive of a plaintiff's computer should be produced to the defendant in order to determine how much time the plaintiff spent on Facebook.

That court also cited a U.S. case, *Ledbetter v. Wal-Mart Stores, Inc.*,<sup>48</sup> wherein the plaintiff moved for a protective order seeking to bar the production of his social media content. However, the court denied the plaintiff's motion and held that the information was reasonably calculated to lead to the discovery of admissible evidence and was relevant to the issues in the case. It's also interesting to note that other courts have required plaintiffs to produce in discovery their passwords and login information to their social networking accounts.

Not surprisingly, some courts have reached opposite conclusions. For example, in *McCann v. Harleysville Insurance Company of New York*<sup>49</sup> the court held that before a defendant will be granted access to the contents of the plaintiff's social media account, it must provide a specific reason to seek such information and that a "fishing expedition" will not be tolerated. In other words, courts generally appear to be in favor of allowing the examination of content within a person's social networking account so long as the request is relevant in scope and evidence reflects that the account will likely contain non-privileged matter that is material and necessary to the defense or prosecution of the case.

Accordingly, when interviewing an insured or claimant as part of a claims investigation, or when deposing a witness or issuing discovery, consideration should be given to asking questions concerning whether social media accounts exist and the type of information contained therein. However, it is important to note that information gained by viewing a person's social networking account should not be considered as conclusive evidence as many people embellish their profiles and activities on the Internet. Also, it can be difficult to draw evidentiary conclusions from Internet photos or postings that lack a basis to establish their authenticity or the time and date of their creation.

Insurance investigators should also be cautioned against "friending" someone through the use of impersonation or false information in order to gain access to that person's social networking account. Such conduct would likely be viewed as deceptive, a form of misrepresentation and lacking in good faith by a court. In addition, communication with individuals who are represented by legal counsel via the use of social media should also be avoided. Finally, it is also important to note that many insurers have strict procedural guidelines concerning the proper use of their company computer equipment by employees. Accordingly, claims investigators should strive to remain in full compliance with their companies' procedural guidelines in regard to these issues.

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<sup>47</sup> *Bishop v. Minichiello*, 2009 BCSC 358, CanLII, 2009.

<sup>48</sup> *Ledbetter v. Wal-Mart Stores, Inc.*, LEXIS 126859, D Colo 2009.

<sup>49</sup> *McCann v. Harleysville Insurance Company of New York*, 2010 N.Y. App. Div LEXIS 8396, 2010.



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### **C. Prior Claims**

When bringing a bad faith claim, the insured will likely seek discovery of documents relating to prior claims and attempt to use these documents to show that the insurer has a history of certain actions (“a general pattern, practice, and policy”) that the insured argues constitutes bad faith.<sup>50</sup> Depending on the number of files sought, the cost of complying with this discovery can be expensive.<sup>51</sup>

In class actions alleging widespread bad faith claims handling practices in a certain type of claim, a court could require the disclosure of a sampling of claims files in order for the insured to prove whether it can meet the procedural requirements for the certification of a class action.<sup>52</sup> In this situation, the fight centers on the number of claims files that must be produced.<sup>53</sup>

In a non-class action, the discovery of prior claims files depends on the facts of the case, the allegations of the plaintiff, and the court. Some courts allow discovery of claims files and some bar it.<sup>54</sup> In any analysis, the discovery of prior claims files balances the privacy/confidentiality rights of the company’s insureds with the relevancy of the files to the particular bad faith action.<sup>55</sup> As to the relevancy argument, the insurer generally will need to establish that the prior claims files are wholly not relevant to the bad faith action.<sup>56</sup> Depending on the facts of the case and the court in which the bad faith action is pending, the insurer may have difficulty establishing to the court the irrelevance.<sup>57</sup>

As to an insured’s right to privacy from having its closed claim files turned over to a person unknown to him/her, the privacy rights of the insureds could be controlled by federal and state law.<sup>58</sup> The particularities of state law may foreclose the discovery of prior claims files without the insured’s consent, consent that the court may require the insurer to seek.<sup>59</sup> However, a plaintiff could attempt to bypass these privacy concerns by demanding redacted claims files.<sup>60</sup>

### **D. Insurance Claim Personnel Files**

Significant concerns are faced when a plaintiff in a bad faith action demands the personnel files of the claims staff involved in the claim. When the request is an extremely broad request for the entire files of multiple individuals, not only are there significant privacy concerns relating to confidential personal information, but the personnel file may contain trade secrets of the company.<sup>61</sup>

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<sup>50</sup> *Bravo v. United States Life Ins. Co. in the City of New York*, No. CIV S-08-1982 LKK, 2009 WL 3823915, at \*1 (E.D. Cal. Nov. 13, 2009).

<sup>51</sup> See *Poneris v. Pennsylvania Life Ins. Co.*, No. 1:06-cv-254, 2007 WL 3047232 (S.D. Ohio Oct. 18, 2007) (\$8,900 estimated cost).

<sup>52</sup> See, e.g., *Seabron*, 862 F. Supp. 2d 1149.

<sup>53</sup> *Id.*

<sup>54</sup> See *Poneris*, 2007 WL 3047232 (collecting cases); *First Coast Energy LLP v. Mid-Continent Casualty Co.*, No. 3:12-cv-281-J-32MCR, 2013 WL 5928970, at \*2 (M.D. Fla. Nov. 1, 2013) (allowing discovery of claims files which have final determinations of coverage) (Florida law).

<sup>55</sup> See *Poneris*, 2007 WL 3047232, at \*1; *Adams v. Allstate Ins. Co.*, 189 F.R.D. 331, 333 (E.D. Pa. 1999); *Penford Corp. v. Nat’l Union Fire Ins. Co. of Pittsburgh, PA*, 265 F.R.D. 430, 432 (N.D. Iowa 2009).

<sup>56</sup> *Penford*, 265 F.R.D. at 434.

<sup>57</sup> See, e.g., *Permanent General Assurance Corp. v. Superior Court ex rel. Hernandez*, 19 Cal. Rptr. 3d 597 (Cal. 4th Ct. App. 2004) (alleging racial discrimination in the denying of claims).

<sup>58</sup> See *Paolo v. Amco Ins. Co.*, No. 02-02367 JW, 2003 WL 24027877 (N.D. Cal. Sept. 17, 2003).

<sup>59</sup> See *Id.* (requiring insurer to send out consent forms).

<sup>60</sup> See *Bravo*, 2009 WL 3823915, at \*2 (allowing production of redacted files that “avoid[s] any breach of privacy”).

<sup>61</sup> See *Humphreys v. Caldwell*, 881 S.W.2d 940, 945-46 (Tex.App.-Corpus Christi 1994).

A request for general discovery must be shown that the request is “reasonably calculated to lead to admissible evidence,” which is a loose standard.<sup>62</sup> A court may require a “heightened standard of relevance” when personnel files are requested.<sup>63</sup> Speculation only on the part of the plaintiff is not sufficient to meet this standard.<sup>64</sup> Ultimately, though, the production of a personnel file can be a frightening thing for the employee because the potentially embarrassing contents of the file are laid open, creating fodder for an overly aggressive plaintiff’s attorney in a deposition. Courts recognize the extreme sensitivity of this issue and are therefore cautious about these files.<sup>65</sup>

A request for the personnel file of every person who touched the claim is generally not allowed.<sup>66</sup> In addition, if the specific information sought by the plaintiff could be obtained through a deposition, a court may prohibit the production of the personnel file.<sup>67</sup> With regard to adjusters who worked on the claim, a court could order the production of documents within the personnel file regarding “background, qualifications, training and job performance.”<sup>68</sup> A court could even order the disclosure of information related to disciplinary actions taken against the adjuster if the information is reasonably calculated to lead to evidence admissible in the bad faith claim.<sup>69</sup> Further, if supervisors of the adjusters assisted in adjusting the claim, the same information may also be obtained from their personnel files.<sup>70</sup> If the involvement of these supervisors is “minimal” or “incidental,” a court should preclude discovery of their personnel files.<sup>71</sup>

Where a court does order the production of the contents of a personnel file, the production should properly be controlled through a protective order that forbids disclosure of the file beyond the action and protects the privacy of the adjuster.<sup>72</sup>

## **E. Examination Under Oath Attorney’s Files**

EUO provisions are typical in an insurance contract, requiring the insured to take an oath and answer questions about the claim. As part of this process, the insured is typically requested to produce documents at the EUO. EUO provisions do not designate who will take the EUO, but typically, the individual is an attorney engaged by the company.

The EUO attorney’s work depends on the nature of the claim and the particularity of the insurance policy. Generally, an EUO attorney works to gather all the facts necessary to the company’s evaluation of the claim, including background facts regarding the insured and other individuals involved in the claim. The attorney analyzes these facts in light of the insurance policy to provide an analysis and opinion addressing coverage. The attorney most likely memorializes this analysis in an opinion letter to the company, which includes a recommendation that the company extends or denies coverage.

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<sup>62</sup> Fullbright v. State Farm Mutual Ins. Co., No. CIV-09-297-D, 2010 WL 300436 (W.D. Okla. Jan 20, 2010).

<sup>63</sup> Carlucci v. Maryland Cas. Co., No. Civ.A. 98-3294, 2000 WL 298925, at \*1 (E.D. Pa. Mar. 14, 2000).

<sup>64</sup> Fullbright, 2010 WL 300436, at \*4. (speculation that adjuster pay is influenced by the denial of claims is not sufficient grounds to obtain pay/salary information from personnel files); but see Grange Mutual Ins. Co. v. Trude ex rel. Wilder, 151 S.W.3d 803, 807, 815 (Ky. 2004) (allowing discovery of salary data and bonuses where there was an allegation that the adjuster undervalued the claim which would be related to the adjuster’s compensation based on saving the insurance company money).

<sup>65</sup> Fullbright, 2010 WL 300436, at \*3.

<sup>66</sup> See Ayala v. Am. Sec. Ins. Co., 2009 WL 1873645, at \*1 (S.D. Fla. June 30, 2009); Fullbright, 2010 WL 300436, at \*4.

<sup>67</sup> See, e.g., Carlucci, 2000 WL 298925.

<sup>68</sup> Fullbright, 2010 WL 300436, at \*4. This could include copies of yearly performance evaluations. Anspach v. United of Omaha Life Ins. Co., Civ. No. 10-5080-JLV, 2011 WL 3862267, at \*11 (D. S.D. Aug. 31, 2011).

<sup>69</sup> Fullbright, 2010 WL 300436, at \*4; Grange Mutual Ins. Co., 151 S.W.3d at 815.

<sup>70</sup> Id.

<sup>71</sup> See Maharaj v. GEICO Cas. Co., 289 F.R.D. 666, 673 (S.D. Fla. 2013). (requiring more evidence of individuals involved in adjusting claim to determine if “actually had more than incidental or minimal involvement in adjusting the claim.”)



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If the company extends coverage, this is typically the end of the claim, and the EUO attorney's files are not in controversy. The claim, however, could always be re-opened if the insured requests additional coverage. Where the company declines coverage and the insured sues for bad faith denial of that claim, the EUO attorney's files may become important because the attorney had a role in the evaluation of the claim.

## **F. What is privileged?/Who is the client?**

There are two considerations with respect to the files of an EUO attorney: (1) the work product doctrine; and (2) the attorney-client privilege. These protections are entirely distinct from each other, with the work product doctrine providing looser protection than the attorney-client privilege.<sup>73</sup>

Work product is typically those things that are prepared in anticipation of litigation with the insured.<sup>74</sup> Attorney-client privilege covers confidential communications between a lawyer and client connected to the provision of legal advice.<sup>75</sup> In the situation of an EUO attorney, the insurance company, as client, engages the lawyer to provide legal advice as to whether the factual circumstances of a claim warrant coverage under the insured's contract of insurance. For the maximum protection, the lawyer should be engaged to provide his/her legal opinion, not merely to assist in the investigation and adjusting of the claim. If the lawyer is not engaged to provide legal advice, all communications with the attorney may very well not be protected as attorney-client communications.<sup>76</sup>

The attorney-client privilege is a product of state law, even if the case is in federal court through diversity jurisdiction.<sup>77</sup> Work product doctrine, by contrast, is a procedural doctrine determined through whatever procedural rules govern the proceeding (state or federal).<sup>78</sup>

As to attorney-client privilege, it is not surprising that the answer to the question of whether the privilege protects an EUO attorney's file from discovery may differ depending on the state where the claim arises. For example, in a bad faith claim in Ohio, privilege attaches to files and communications generated after the denial of coverage.<sup>79</sup> Therefore, the EUO attorney's files, including all communications between the attorney and any employee/agent of the company, are fully discoverable.<sup>80</sup> While this is a minority rule, the Ohio approach to the EUO attorney files is absolute.<sup>81</sup>

A particular issue arises when the insured brings a breach of contract action for the denial of the claim and simultaneously brings a bad faith action. If both actions were allowed to go forward simultaneously, the insured would be allowed to discover and use against the company all of the company's thoughts, impressions, and legal conclusions leading up to the denial of coverage for the claim. The insured goes to trial on the breach of contract action knowing the whole gamut of factual and strategic information while the insurance company only knows what it has discovered. This result is avoided, however, through a stay of the bad faith action or a bifurcation of the breach of contract and bad faith actions.<sup>82</sup>

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<sup>72</sup> Anspach, 2011 WL 3862267 at \*10.

<sup>73</sup> See generally *Genovese v. Provident Life and Accident Ins. Co.*, 74 So.3d 1064, 1067-69 (Fla. 2011).

<sup>74</sup> *Id.* at 1067 (Florida law).

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* at 1068.

<sup>77</sup> Steven P. Perlmutter, *The Implied Waiver of the Attorney-Client Privilege in Insurance Bad Faith Cases*, 41-SPG Brief 46, 48 (Spring 2012);

*Cummins, Inc. v. Ace Am. Ins. Co.*, No. 1:09-cv-00738-JMS-DML, 2011 WL 1832813, at \*1 (S.D. Ind. May 2, 2011).

<sup>78</sup> *Auto Owners Ins. Co. v. Totaltape, Inc.*, 135 F.R.D. 199, 201 (M.D. Fla. 1990).

<sup>79</sup> *Boone v. Vanliner Ins. Co.*, 91 Ohio St. 3d 209 (Ohio 2001).

<sup>80</sup> *Id.* at 213-15.

<sup>81</sup> Perlmutter, 41-SPG Brief at 48.

<sup>82</sup> *Id.*

The majority approach to an EUO attorney's files is more nuanced than Ohio's approach. For example, in Florida, the documents of an EUO attorney are discoverable, but not those documents that do not contain attorney-client communications "involv[ing] the rendering of legal advice."<sup>83</sup>

If in a state that recognizes the protection of the EUO attorney's files either under a work product doctrine protection or attorney-client privilege, the company can impliedly waive the protections. Differing by state, the company does not impliedly waive the protections merely by defending the bad faith suit by asserting that it did not act in bad faith.<sup>84</sup> But, where the company asserts that it relied on the EUO attorney's opinions in its decisions, the company has waived the protections of the attorney-client privilege and work product doctrine.<sup>85</sup> Different jurisdictions have differing standards as to the level of assertion that results in a waiver.<sup>86</sup> Therefore, the insurer's actions in defense of the bad faith claim, whether intended or unintended, can have important strategic consequences.

## VII. Litigation and Trial of the Arson/Bad Faith Case

### A. *Daubert* or Other Expert Challenges

In trial, different forms of testimony may be offered in the defense of a bad faith action. Factual testimony or testimony as to the events that occurred is the most common. Opinion testimony is an entirely different form of testimony and is subject to great restrictions in its admissibility as evidence in a trial. Generally given by experts, opinion testimony is treated as a special form of testimony because of its power of persuasion and the emphasis it could have on the jury. Because of this, courts act as a gatekeeper, excluding evidence that does not meet the expert evidentiary standards set forth and applied by the United States Supreme Court in three famous cases known as the "Daubert Trilogy": *Daubert v. Merrell Dow Pharmaceuticals, Inc.*; *General Electric Co. v. Joiner*; and *Kumho Tire Co. v. Carmichael*.<sup>87</sup>

Originally a standard only for expert testimony in federal court cases, the vast majority of states have now adopted these standards or some hybrid of these standards.<sup>88</sup> Experts are those individuals who have the necessary "knowledge, skill, experience, training, or education" in a given subject, enabling them to testify as to their opinion on a specific issue in the case.<sup>89</sup> The party offering the expert evidence must meet the expert evidentiary standards first announced in *Daubert* and now codified by the Federal Rule of Evidence 702:



1. The expert's scientific, technical, or other specialized knowledge will help the trier of fact [the jury] to understand the evidence or to determine a fact in issue;
2. The testimony is based on sufficient facts or data;
3. The testimony is the product of reliable principles and methods; and
4. The expert has reliably applied the principles and methods to the facts of the case.

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<sup>83</sup> Genovese, 74 So.3d at 1068.

<sup>84</sup> Steven Plitt, et al., 17A Couch on Ins. § 250:55.

<sup>85</sup> Id., Perlmutter, 41-SPG Brief at 48-52.

<sup>86</sup> Id.

<sup>87</sup> *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993); *General Electric Co. v. Joiner*, 522 U.S. 136 (1997); and *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

<sup>88</sup> See, Committee. on Judiciary, Florida Senate, Issue Brief 2009-331: Analysis of Law Relating to Admissibility of Expert Testimony and Scientific Evidence (Oct. 2008) (available at: [http://archive.flsenate.gov/data/Publications/2009/Senate/reports/interim\\_reports/pdf/2009-331ju.pdf](http://archive.flsenate.gov/data/Publications/2009/Senate/reports/interim_reports/pdf/2009-331ju.pdf)) (last visited Jan. 3, 2014).

<sup>89</sup> Fed. R. Evid. 702.



Even if the testimony meets these requirements, the judge may still exclude the testimony if the substance of the expert testimony causes “unfair prejudice, confusion of the issues, waste of time, or needless presentation of cumulative evidence.”<sup>90</sup> Where an expert witness offers several opinions, each of these opinions can be challenged, typically before trial, using the above causes. The court could exclude the expert entirely or could limit the expert’s testimony to only those opinions that meet the standards.

Bad faith experts run the gamut from “professional experts” who routinely testify on behalf of plaintiffs to former industry officials.<sup>91</sup> In a bad faith action, experts are mostly not allowed, especially in cases where the claim is straightforward and expert testimony will not assist the jury.<sup>92</sup> Where expert testimony has been admitted, jury verdicts have sometimes been overturned.<sup>93</sup>

Where an expert has no experience in the insurance industry, much less as an adjuster within the industry, the expert should not be allowed to opine on whether the insurance company acted in accordance with industry standards.<sup>94</sup> An expert should not be allowed to testify as to the meaning of the laws that govern an insurance company and whether the company acted in contravention to the law.<sup>95</sup> But, where a court allows an expert to testify as to specific legal standards and how those legal standards underpin the expert’s conclusions, the court may give what is known as a “limiting instruction,” instructing the jury that the judge’s instruction on the law prevails.<sup>96</sup> A court may wholesale exclude the testimony, though, where the testimony interprets or clearly misstates the law.<sup>97</sup>

Where a plaintiff challenges the company’s claim handling practices, an expert should not be able to testify as to the handling practices of prior claims because it could force a series of “mini-trials” within the trial whereby the company would be forced to marshal evidence of every claim mentioned to rebut the assertion that it acted in bad faith in every one of the claims mentioned.<sup>98</sup> But an expert could be allowed to testify that the “company-wide scheme” at issue contravenes industry principles and ethics.<sup>99</sup>

On an individual claim level, an expert may testify as to whether the loss reserves set were sufficient, depending on the court.<sup>100</sup> In addition, depending on the claim at issue, expert testimony may be allowed as to the subjective intent of company individuals involved in the claim.<sup>101</sup> The expert should not be able to give his/her opinion that the company acted in bad faith because this is the ultimate legal conclusion reserved for the jury.<sup>102</sup>

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<sup>90</sup> King v. Allstate Ins. Co., No. 11-cv-00103-WJM-BNB, 2013 WL 3943607, at \*1 (D. Colo. July 31, 2013) (quoting Fed. R. Evid. 403).

<sup>91</sup> See, e.g., *Id.*

<sup>92</sup> Imperial Trading Co. v. Travelers Prop. Cas. Co. of Am., 654 F. Supp. 3d 518, 519 (E.D. La. 2009) (collecting cases); Smith v. Allstate Ins. Co., 912 F. Supp. 2d 242, 251 (W.D. Pa. 2012).

<sup>93</sup> Steven Plitt, et al., 17A Couch on Ins. § 252:25

<sup>94</sup> King, 2013 WL 3943607, at \*2.

<sup>95</sup> *Id.* at \*5.

<sup>96</sup> *Id.*

<sup>97</sup> Imperial Trading Co., 654 F. Supp. 3d at 522; Smith, 912 F. Supp. 2d at 253.

<sup>98</sup> Royal Bahamian Ass’n, Inc. v. QBE Ins. Corp., 745 F. Supp. 2d 1380, 1384 (S.D. Fla. 2010).

<sup>99</sup> Hangarter v. Paul Revere Life Ins. Co., 236 F. Supp. 2d 1069, 1091 (N.D. Cal. 2002), overruled on other grounds, Hangarter v. Provident Life & Acc. Ins. Co., 373 F.3d 998 (9th Cir. 2004).

<sup>100</sup> King, 2013 WL 3943607, at \*4, 7-8.

<sup>101</sup> Jeffrey Michael Cohen and E. Kelly Bittick, The Use and Misuse of Expert Testimony in Bad Faith Actions, available at [http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2013\\_insurance\\_coverage\\_litigation\\_committee/b\\_4\\_1.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2013_insurance_coverage_litigation_committee/b_4_1.authcheckdam.pdf) (last visited Jan. 24, 2014) (comparing cases).

<sup>102</sup> Gallatin Fuels, Inc. v. Westchester Fire Ins. Co., 410 F. Supp. 2d 417, 422 (W.D. Pa. 2006).

### ***B. Proper Preparation of the Insurance Company Witnesses***

Company witnesses can either be fact witnesses or designated as corporate representatives of the company with the ability to speak on behalf of and bind the company to the testimony. A company in a bad faith action may designate multiple corporate representatives to speak on different topics, such as one person to testify regarding claims handling practices in general and another to testify as to the handling of the insured's claim. A plaintiff, then, may take the depositions of company individuals who are not designated corporate representatives by the company but who were involved in the claim.

No matter the type of witness, six things are critical to keep in mind when testifying in a deposition or trial: (1) appearance; (2) demeanor; (3) body language; (4) careful listening; (5) truthfulness; and (6) preparation.

The first three things are closely related and apply in both depositions and trials. The company witness should always have a professional appearance and demeanor while testifying. Men should be dressed in suits and women dressed in suits or dresses, all with a professional, respectful demeanor to match the seriousness of the proceeding. When being questioned, the witness should maintain eye contact with the questioner, for this projects a respectful message to those observing and assists the witness in careful concentration on the question asked. When answering a question, the witness at trial should turn to the jury and project the answer to the jury.

Careful listening is a vital element of any testimony. Wait until the question is finished before answering. If the attorney has to continually ask a question several different ways before obtaining a direct answer, the jury may infer negative things about the witness – like the witness is trying to evade the question or, worse, lying. If the witness does not understand the question, asking for clarification is acceptable. Misinterpreting the question and answering based on that misinterpretation could cause issues.





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The questioning attorney might try to get a witness to adopt a characterization the attorney uses, a characterization that might be misleading. Listening closely can prevent this. For example, if the witness is asked, “Was it raining when you arrived at the scene,” and the witness answers “Yes,” the witness has adopted the attorney’s characterization of what rain is. There is nothing wrong with rephrasing the question during the answer if the witness disagrees with the attorney’s characterization. A better response would be, “When I arrived at the scene, it was sprinkling.” On a related point, the witness should try to be as clear as possible when answering questions so that there can be no dispute as to the answer. If an event occurred at 9:30 p.m., say 9:30 p.m. and not 9:30.

No matter what the circumstances are, even if the answer may seem bad, always tell the truth. Not telling the truth could have disastrous consequences, some even criminal (perjury).

Preparation is an important aspect of any testimony. Proper preparation includes reviewing the portions of the file for which the witness is responsible so as to refresh memories as to what occurred during the claim. The witness should also meet with the attorney representing the company to discuss any questions and to conduct mock questioning. Mock questioning (on video especially) is helpful because it will prepare the witness for answering questions while testifying. Here, the witness will have a chance to consider how the answers sound or how the witness looks. The amount of preparation may be more or less in depth than the preparation described above depending on the witness’ involvement in the claim and case.

Thoroughly prepared, the witness should only answer questions within the witness’ level of knowledge of the file. The witness should not speak outside his/her knowledge or guess at the answer. If the witness knows the answer, then he/she should respond accordingly. If the witness never knew the answer, the response “I don’t know” should be given. If the witness knew the answer but has since forgotten, then an “I don’t remember” response is appropriate. If the witness remembers something that should be added to a particular answer further into the deposition or trial testimony, the witness should indicate that to the attorney asking the questions.

### ***C. Understanding the Venue and Opposition***

Venue is understanding the area in which the lawsuit has been brought, which may be able to be brought in different courts depending on the particular facts of the case.<sup>103</sup> Venue considerations depend on geographic, demographic, and sociologic concerns that are well known to corporate officials and field adjusters. These types of venue considerations inform insurers and their counsel about the type of individuals who may appear for jury selection.

More subtle types of venue considerations, on the other hand, may be of valuable importance to the company. For example, considerations about the judiciary can be critically important, particularly in a bench trial where the judge acts as the jury. In addition, federal court, as opposed to state court, might be a more advantageous option because of the more structured decision-making and adjudicating of a lawsuit.

Considerations about the opposition, however, are more fluid and can change how the company and its attorneys handle the case. Who is the insured’s counsel? What is counsel’s track record? Number of appeals overturned because of improper statements to the jury? Does counsel go to trial or typically settle? Does counsel prepare thoroughly, exploring every avenue, or does counsel wing it? Is the insured’s bad faith counsel different from his/her counsel in the underlying breach of contract action? If so, why? (The insured’s attorney may be an attorney who specializes in bad faith.)

Because bad faith claims are typically tried before juries, understanding the potential make-up of the jury and how the opposition might impact the jury are key considerations in the defense strategy of every bad faith claim.

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<sup>103</sup> See, e.g., *N. States Power Co. v. Cont’l Ins. Co.*, 805 N.W.2d 734 (Wis. Ct. App. 2011) (declaratory action brought in Minnesota, breach of contract action brought in Wisconsin).

Choosing a corporate representative is an important decision because the representative's testimony binds the company and can fully be used against the company. It does not have to be a singular person; it can be multiple individuals to speak only on specific topics.<sup>104</sup>

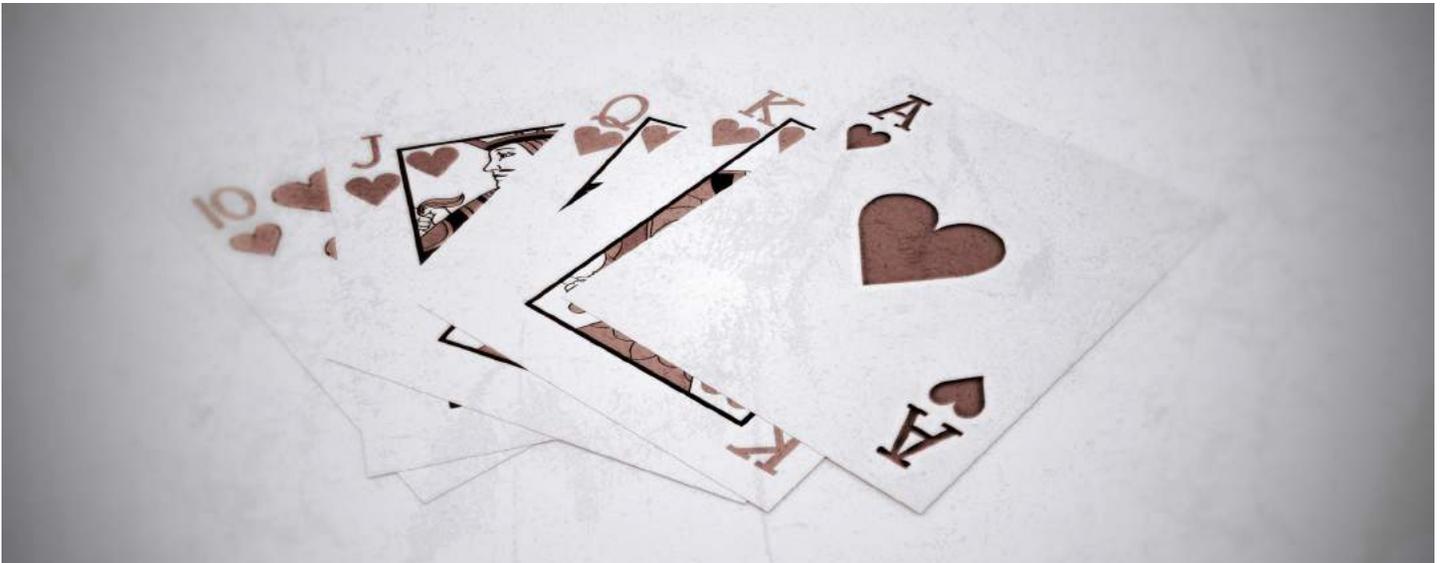
The process of choosing a corporate representative actually begins with opposing counsel who chooses the areas of inquiry. If an allowable area of inquiry, the company should select the person who is most knowledgeable and will best testify as to the area of inquiry. That person has a duty to be thoroughly prepared with respect to the areas of anticipated inquiry for which he/she is selected.<sup>105</sup> Not being prepared despite being designated is considered failing to appear, the consequence of which may very well be sanctions against the company.<sup>106</sup>

Many times, the corporate representative is a seasoned professional who has been a witness in multiple other proceedings and knows how to conduct himself/herself appropriately. However, where the designated corporate representative has little experience testifying, extensive preparation will serve to fully prepare that person to speak on behalf of the company. It may also be helpful to consider the selection in light of where the case is pending.

## ***E. Knowing When to Hold and When to Fold***

### ***i. Making the Business Decision***

In the face of a weak bad faith claim, making a business decision to settle the case can be difficult for the company. The prospect of ultimately winning the case might be strong, but the financial cost associated with winning the case may be too great. But, when facing a strong bad faith claim, especially one that has garnered media attention, the company may want to avoid the public spectacle of a trial. The business decision there incorporates considerations that impact the company's future business plans.



Nevertheless, the company may wish to continue defending a particular action in order to develop the case law on a particular point at issue in the lawsuit. This particular strategy could backfire, especially if a jury determines the application of company-wide practices to be bad faith.

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<sup>104</sup> See, e.g. *Resolution Trust Corp. v. S. Union Co., Inc.*, 985 F.2d 196 (5th Cir. 1993).

<sup>105</sup> *Black Horse Lane Assoc., L.P. v. Dow Chemical Corp.*, 228 F.3d 275, 303-04 (3d Cir. 2000) (collecting cases).

<sup>106</sup> *Id.*



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When making the business decision, the company should work closely with the company's attorney to ensure both have a full understanding of the legal atmosphere regarding the particular claim. Only then will the company be able to make an informed business decision.

### *ii. Proper Valuation of the Case*

In large part, the proper valuation of a case depends on the specific nature of the case and can be driven by the venue in which the claim lies, the type of claim, the parties involved, and the egregiousness of the facts. The valuation of the case is a difficult endeavor, particularly because of the unpredictable nature of juries and the potential for punitive damages. Verdict reporters can be helpful in providing some guidance to the company in the valuation process. Additionally, court decisions or state-specific statutes may limit the amounts of punitive damages that can be awarded.<sup>107</sup> If the jury's verdict awards punitive damages in excess of an amount allowed by law, a court can lower the punitive damages to the correct amount.<sup>108</sup>

Because of the many factors that can affect the valuation of the case, the company should look to the attorney to assist the company in placing a value on the bad faith claim. The attorney should be able to assist the company in determining the amount of exposure it faces.

### *iii. Who/What is the Weakest Link ?*

The weakest link that may prove detrimental to the company's defense of a bad faith claim may often come in one of two forms: (1) damaging facts; or (2) damaging law.

Where possible, damaging facts should be identified before the bad faith claim is asserted. If the claim is still being investigated, the company can move to correct its actions. In a breach of contract action, the company can attempt a global settlement that would release the company from any bad faith claims. All company employees must be forthright and honest with the company's attorney, for an attorney cannot prepare to defend against something if he/she is blindsided.

Recognizing the weakest legal link, however, is an entirely different endeavor. For an insurer that operates in many states, different states have different legal approaches to the insurance industry. Even inside of a single state, there can be different judicial interpretations of the same statute, case law or policy language. Until the highest court in that state resolves the conflict, courts in separate areas of the state may apply the law in ways that creates headaches for the company.

Identifying and understanding these weak links is absolutely necessary for the company and the company's attorneys. Without a full understanding of the panoply of information, the weakest link may very well break, causing substantial harm to the company.

## ***F. When to Retain a Bad Faith Expert***

As noted previously, testifying bad faith experts are not always needed, much less allowed, in the prosecution or defense of a claim. But, a negative answer to the question of whether a court will ultimately allow an expert to testify should not solely guide the company's decision in whether to hire a bad faith expert.

There is a distinct difference between a consulting expert and a testifying expert. A consulting expert generally remains hidden from the opposing party, and communications with a consulting expert generally are privileged.<sup>109</sup> Where the company has no plans to use this particular expert as a witness at trial, the expert can be brought on at the earliest opportunity to assist in the investigation of the facts and the defense of the case.

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<sup>107</sup> See, e.g., Fla. Stat. 768.73 (2013).

<sup>108</sup> Sun Int'l Bahamas, Ltd. v. Wagner, 758 So. 2d 1190 (Fla. 3d DCA 2000).

<sup>109</sup> See, generally, In re Mendez, 234 S.W.3d 105, 108 (Tex. App.-El Paso 2007).

With a testifying expert, however, the company must be more careful. Communications among the expert, counsel for the company, and company officials may be discoverable, including documents given to and used by the expert. Strong considerations must be given to obtaining an expert to rebut an expert obtained by the opposing party. If the opposing party's expert's testimony is admissible and the company fails to retain an expert to testify in opposition to this expert's testimony, it looks bad in front of a jury. In a bad faith claim, the company must not take this chance.

***G. Pre-Emptive Strike – Whether to File a Declaratory Action in Advance of Suit by the Insured***

A declaratory action seeks to determine the rights and legal obligations of the parties to the action.<sup>110</sup> The insurance company would file the action as plaintiff. Being the plaintiff in a lawsuit comes with several distinct advantages. These include: being able to pick the forum in which the suit will be heard, being the party that drives the litigation, setting the tone, and being the first party to speak to the jury in opening statements and the last party to speak to the jury in closing arguments.

Many times, this is a decision that is driven by the factual and legal landscape facing the insurer. For instance, there may be key strategic considerations that favor the insurer filing a declaratory action in one state rather than having the insured sue in a different state.<sup>111</sup> Courts have made clear that declaratory judgments, though, “are not to be utilized as instruments of procedural fencing, either to secure delay or to choose a forum.”<sup>112</sup>

Where there is a disputed fact at issue, a court may be more likely to determine that the insurance company has raced to the courthouse to file a declaratory action so that it could obtain the status and advantages as plaintiff.<sup>113</sup> Further, if the insured countersues the company and alleges breach of contract, a court may order the parties be realigned so that the insured takes the position as plaintiff even though the company filed the lawsuit.<sup>114</sup> This realignment of the parties could destroy the jurisdiction of the federal court, a court which is procedurally usually more advantageous for the insurance company.<sup>115</sup>

The insurance company obtains many benefits through a pre-emptive strike, the declaratory action. An advantage includes the ability to legitimately raise the issue to the court and the plaintiff of how bad faith can apply to action taken by the insurer to determine/review coverage. To make the issue even more forceful, consideration should be given to a coverage decision letter addressed to the insured that offers to file a declaratory judgment, but only if the insured consents (since the insured would incur legal fees).

It should be noted, however, that where a court finds that the pervasive question is whether the insurance company breached the contract a court may call foul and realign the parties so that the insured occupies the plaintiff's chair.

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<sup>110</sup> Green v. Goodman-Gable-Gould Co., 597 S.E.2d 77, 80 (Va. 2004).

<sup>111</sup> See, e.g., N. States Power Co. v. Cont'l Ins. Co., 805 N.W.2d 734 (Wis. Ct. App. 2011) (insurer would allegedly win in one state and allegedly lose in another).

<sup>112</sup> Green, 597 S.E.2d at 80 (quoting Williams v. S. Bank of Norfolk, 125 S.E.2d 803, 807 (Va. 1962) (internal quotation marks omitted).

<sup>113</sup> Id.

<sup>114</sup> U.S. Fidelity and Guaranty Co. v. A & S Manufacturing Co., 839 F. Supp. 347 (D. Md. 1993).

<sup>115</sup> Id.



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## **H. Jury Versus Bench Trial/Bifurcation of Bad Faith and/or Damages**

Trying a case before a jury that renders a verdict is a decision that rests with the parties. A jury is not required.<sup>116</sup> In fact, a jury trial may not be available depending on the jurisdiction.<sup>117</sup> As a matter of practice, though, parties typically demand a jury trial at the outset of the case because not doing so could result in a waiver. The very important decision of whether to try a case before a jury or a judge is finalized when the case is ready to go to trial.

The company may want to present its case to a jury where the presiding judge has a plaintiff-friendly background or has tended to favor the plaintiff in the litigation. A judge may place strong emphasis on facts that might be discounted by a jury and punish the company for its perceived actions. Moreover, in a situation where the insured's bad faith case is very weak or if the insured is a very unsavory character, the company may wish to present the jury with a showing of the key distinctions between the insured's actions and the actions of its employees.

In jurisdictions where an action for damages resulting from breach of contract can be brought simultaneously with a count for bad faith denial of the claim, bifurcation prevents possible prejudice from the jury as well as prevents juror confusion.<sup>118</sup> Because of these considerations, a court can split these two causes of action.<sup>119</sup> Splitting of these actions, though, may not be a mandatory requirement.<sup>120</sup>

In particularly complex bad faith cases, the judge may be able to understand the case better than a jury. The judge may also be able to fairly judge the question of breach of contract and bad faith in one trial. In these situations, substantial time and effort are saved trying the case before the judge. The judge is presumably current on the law, and less confusion results from having to understand the law and keep hold of all the complex facts. The company can realize substantial savings in legal costs because a jury trial is typically more expensive than a bench trial. It should be noted that in some circumstances the court, on its own volition, may be able to call what is known as an "advisory jury" to decide some of the issues or to assist the court in reaching its factual conclusions.<sup>121</sup>

A trial by jury is one of the pinnacles of the American judicial system, but the decision to try a case before a judge is not one to be immediately discounted. The company must work with its attorneys and gather all the relevant facts before making this important choice.

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<sup>116</sup> See, e.g., *Firemen's Ins. Co. of Newark, N.J. v. Smith*, 180 F.2d 371 (8th Cir. 1950).

<sup>117</sup> See *Mishoe v. Erie Ins. Co.*, 824 A.2d 1153 (Pa. 2003) (In Pennsylvania, no right to jury trial in statutory bad faith action)

<sup>118</sup> *Massachusetts Mut. Life v. Watson*, Nos. 12-19-KKC, 12-151-KKC, 2013 WL 142431, at \*1 (Jan. 11, 2013).

<sup>119</sup> *Id.*

<sup>120</sup> *State ex rel. Allstate Ins. Co. v. Beddell*, 506 S.E.2d 74 (W. Va. 1998).

<sup>121</sup> See, e.g., *Firemen's Ins. Co. of Newark, N.J.*, 180 F.2d 371.<sup>41</sup> See *Keller v. Nat'l Farmers Union Prop. & Cas. Co.*, No. 12-72-N-DLA-JCL, 2013 WL 27731, at \*4 (D. Mont. Jan. 2, 2013) (must "make[] a threshold showing that publicly available [social media] information . . . undermines the [insured's] claims.").

## **SUMMARY**

This publication serves as a useful tool for educating fire claims professionals on legal issues associated with fire claim investigations leading to allegations of bad faith. It is not complete, and as a digital/print publication can never be ultimately current to the most recent legal development or case.

However, ICAC provides this tool as a way of educating claims professionals and sensitizing them to the issues of good faith claim management pursuit and bad faith claim management avoidance.

Further information on these issues can be obtained by attending various ICAC webinars, visiting its website ([arsoncontrol.org](http://arsoncontrol.org)) and attending its annual training seminar.

We look forward to working with you and supporting your company's efforts to manage fire claims in good faith.

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## **Rick Hammond, Esq.**

*Rick Hammond is a partner at the law firm HeplerBroom, LLC. He serves as national counsel on matters relating to property insurance coverage, fire and explosion cases, and bad faith and as counsel to corporate executives, municipalities, and elected officials on high-profile business litigation cases. He also serves as an expert witness on insurer bad faith and insurance law and coverage issues. He is an adjunct professor on insurance law at the John Marshall Law School.*

*Before practicing law, Rick was the assistant deputy director of the Illinois Department of Insurance's Chicago office, and he held managerial positions in property claims and agency for two national insurance carriers. Rick recently returned to his role as the executive director of the Insurance Committee for Arson Control, after serving many years as ICAC's general counsel.*

*Rick is past president of the Illinois Association of Defense Trial Counsel, was on the faculty and the board of directors of the Insurance School of Chicago, and is a columnist for the International Association of Special Investigation Units' magazine, SIU Today.*

*Rick is a member of the Federation of Defense and Corporate Counsel and chair of its Property Insurance Law Committee. He is also the former Illinois state representative of DRI.*

*In 2008, Rick was one of two attorneys in the country selected by the Lexis Nexis Insurance Law Center to receive its Insurance Lawyer of the Year Award. He was recognized by Lexis Nexis and his peers as having effectively advanced insurer positions and helped improve insurance law from the perspective of insurers. Rick was also inducted into the American College of Coverage and Extra-Contractual Counsel, an organization composed of preeminent coverage and extra-contractual counsel in the United States and Canada.*

## **Matthew J. Smith, Esq.**

*Matthew Smith is president of Smith, Rolfes & Skavdahl Company, LPA. He founded the firm in 1989 after beginning practice as an insurance defense attorney in Florida. Starting as a one-attorney office, the firm has grown to eight offices and now provides insurance law services throughout the United States and Puerto Rico.*

*Originally from Dayton, Ohio, Matthew attended the University of Cincinnati College Conservatory of Music, graduating with a degree in radio, TV, and film. While working his way through college and law school, he served as director of marketing communications for the Kings Island theme park complex in Ohio and founded Smith-Kaufman Public Relations, representing such companies as Wendy's International, Hyatt Hotels, and the Cincinnati Reds.*

*Matthew graduated from the Salmon P. Chase College of Law at Northern Kentucky University. He is admitted to practice in both federal and state courts in Ohio, Florida, Kentucky, Michigan, and Washington, D.C., as well as the United States Supreme Court.*

*He serves as legal counsel to the Coalition Against Insurance Fraud, is a past president of the National Society of Professional Insurance Investigators, chairs the Insurance Committee of the International Association of Arson Investigators, and is a member of the Defense Research Institute, Claims and Litigation Management Alliance, and numerous other insurance-law related organizations. Matthew is a frequent lecturer on insurance law matters throughout the United States.*



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