

## THIRD PARTY BAD-FAITH

Irwin E. Weiss

A liability insurance company and its policyholder have a contractual relationship. When a third party makes a claim against the insurer for damages arising from the negligent conduct of the insured, the carrier naturally wants to pay as little as possible. However, the carrier has a duty to use reasonable care to evaluate the case and to settle within policy limits if that is possible, if it is reasonable, if they fully evaluate the matter, so as not to jeopardize its insured's assets. This article discusses this duty, the breach of which is termed "third-party bad faith" and gives rise to an action against the carrier for failing to settle within policy limits.

The easiest way to begin an article about third party bad faith in Maryland is to start with a discussion of the two early cases from whence the concept has arisen in our state.

### I. Early history in Maryland

In Sweeten v. National Mutual Insurance Co., 233 Md. 52 (1963) the Court was presented with this situation: Mr. Shanley sued Mr. Larson for injuries sustained in a car accident. Larson was insured with National Mutual who could have settled for policy limits. During the course of the case, Larson died. His estate was substituted in the litigation, and the Plaintiff got a judgment in the auto tort case of \$19,000 which was nearly twice the \$10,000 policy available to the Estate.

Sweeten, who was the Personal Representative of Larson's estate, brought suit against the insurer, saying that the Estate's assets were jeopardized by the carrier's refusal to settle the case. The trial judge said that there was no such tort and dismissed the case.

The Court of Appeals, in a case of first impression, held that:

- 1) The liability of a carrier for exercising bad faith sounds in tort, even though it arises from a contractual undertaking.
- 2) The real test is whether the carrier was negligent in adjusting or defending the case.
- 3) The ability of the insured to satisfy the judgment was not relevant.

Therefore, in Sweeten, the Court of Appeals recognized for the first time in Maryland the tort of exercising bad faith and reversed and remanded the case for trial.

A few years later came the case of State Farm v. White, 248 Md. 324 (1967) which built on Sweeten. The underlying case involved a common scenario. The Plaintiff, Mr. Mills, was a passenger in one of two vehicles involved in an accident. He filed suit against both operators. The plaintiff's attorney demanded \$15,000 to settle and communicated this demand to both carriers. State Farm, who insured one of the defendants, Mr. White, was willing to pay half of this demand, but the other carrier was only willing to pay \$5000. State Farm didn't want to pay \$10,000 when the other carrier was only paying \$5000. Two days before trial, the Plaintiff reduced his demand to \$12,500. Once again, State Farm was willing to pay half the demand, but, once again, the other carrier was unwilling to pay more than \$5,000. State Farm wouldn't pay the other \$7,500. In other words, State Farm was willing to pay \$7,500 if the other carrier

would do so, but would not pay \$7,500 to settle the case with the other defendant's carrier paying only \$5,000. So, the case was tried.

The trial resulting in a verdict of \$17,495 against both defendants, but the second defendant won an appeal, leaving the entire \$17,495 verdict intact against the State Farm insured. Unfortunately, the State Farm insured, Mr. White, only had a \$10,000 policy, so there was an excess judgment. The case could have resolved for the total sum of \$12,500, but State Farm would have had to pay \$7,500 with the other defendant's carrier paying \$5,000. But because State Farm didn't want to pay more than the other carrier it jeopardized its insured's assets.

White sued State Farm. It is important to note that this suit was brought by Mr. White against his own insurer for failing to settle. The Court, citing Sweeten and some out of state authorities, held that "For an insurer to measure up to the good faith test, its action in refusing to settle must consist of the informed judgment based on honesty and diligence. Furthermore, the insurer's negligence, if any there be, is relevant in determining whether or not it acted in good faith." 248 Md. at 333.

In State Farm v. White, the Court set forth six factors<sup>1</sup> to consider in evaluating the insurance company's refusal to settle:

- 1. The severity of the plaintiff's injuries and the likelihood of a verdict greatly in excess of the policy limits**
- 2. Lack of proper and adequate investigation of the circumstances surrounding the accident<sup>2</sup>**
- 3. Lack of skillful evaluation of plaintiff's disability**
- 4. Failure of the insurer to inform the insured of a compromise offer within or near the policy limits**
- 5. Pressure on the insured to make a contribution to settlement within policy limits, as an inducement to settle**
- 6. Actions which demonstrate a greater concern for the insurer's monetary interests than the financial risk to the insured**

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<sup>1</sup> Later, these six factors were reaffirmed in Allstate v. Campbell, 334 Md. 381 (1994).

<sup>2</sup> This is one reason why defense attorneys subpoena every medical record, employment record, etc. of the Plaintiff during the litigation. Then, the carrier (and the lawyer) can say that they did a full investigation.

After these two seminal cases, it was clear that an insurer could not simply ignore its insured's economic interests, but would have to exercise due care to evaluate claims and settle the cases, where possible, within policy limits, if there was a real palpable threat to the insured's assets. In addition, insurers began to advise their insureds of the progress of the litigation, and advising them, where they were sued for an amount in excess of their policies, of the right to hire their own counsel.<sup>3</sup> The mere fact that the insured requests that the carrier not settle does not preclude, as a matter of law, the insured from having a cause of action against the carrier for failure to settle, because the insured must be fully informed. The duty to keep an insured fully informed was noted in Schlossberg v. Epstein, 73 Md. App. 415 (1988). But, it is clear that the cause of action belongs to the insured, and not to the Plaintiff.

## II. Assignment to the Plaintiff

As noted, these early two cases make clear that the cause of action for failing to settle within policy limits, thus exposing the insured to an excess judgment, is a cause of action that belongs to the insured, and not to the plaintiff. See also, Bean v. Allstate Insurance Co., 285 Md. 572 (1979). In Bean, a party who was the underlying plaintiff and who obtained a judgment in excess of policy limits lost on a motion for summary judgment. Why? The claim belongs to the insured, because the duty to settle within policy limits is owed to the insured. Therefore, the insurer owed no duty to the underlying plaintiff. There has never been a deviation from that rule.

However, the Court of Appeals has held that a tort plaintiff can sue as the assignee of the insured. The procedure is as follows: The tortfeasor/insured, after losing a verdict in excess of policy limits, assigns his bad faith claim to the Plaintiff, in exchange for agreement not to pursue post-judgment relief against the tortfeasor until the bad faith claim is fully litigated. The assignment of this cause of action was specifically approved in Medical Mutual Liability Ins., Inc. v. Evans, 330 Md. 1 (1993). In that case, the underlying Plaintiff had sued a physician in a medical malpractice case. The Plaintiff was clearly willing to accept a settlement within policy limits. The insurer refused the demand. The jury awarded the underlying Plaintiff \$2.5 million, and the doctor had only a \$1 million insurance policy. The doctor assigned his bad faith claim to the patient, who pursued the insurer.

How do you get this assignment? Plaintiff's counsel corresponds with defense counsel, and proposes the assignment, and requests that the defense counsel communicate the offer to the defendant. Or, one could wait until the judgment becomes final and the appeal period passes, and, at that point, plaintiff's counsel can contact the judgment debtor directly. The defense lawyer no longer represents the defendant at that point. (See, Rule 2-132(d), which states that

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<sup>3</sup> The Rules Committee of the Court of Appeals has proposed a new rule with regard to the ad damnum, namely, that where the amount sued for is greater than \$75,000, (the current amount in controversy threshold for diversity jurisdiction) a plaintiff will only recite in the Complaint that the amount sued for exceeds \$75,000. Thus, if this rule is adopted, insurers will likely send these letters out in any case where the suit is for "in excess of \$75,000". See, <http://www.courts.state.md.us/rules/reports/174threport.pdf> (p. 216).

“When no appeal has been taken from a final judgment, the appearance of an attorney is automatically terminated upon the expiration of the appeal period unless the court, on its own initiative or on motion filed prior to the automatic termination, orders otherwise.”

### III. Damages in a Third Party Bad Faith Case

Let’s say some insurance company ignores the Plaintiff’s policy limits settlement demand of \$30,000 and a verdict results in the amount of \$130,000. The 6 factors set forth in State Farm v. White, supra seem to support the claim. Of course, if the insurer merely writes a check to the Plaintiff for the full amount of the judgment, \$130,000 and obtains an order of satisfaction of the judgment, there are no damages. However, if that does not occur, what are the damages? If the insured, or the Plaintiff as assignee, sues the carrier, what is the measure of damages that the jury should consider?

In Medical Mutual Liability Ins., Inc. v. Evans, 330 Md. 1 (1993) the Court held that: “Present Maryland law, and the majority rule, is that the measure of damages in a bad faith failure to settle case is the amount by which the judgment rendered in the underlying action exceeds the amount of the insurance coverage.” 330 Md. at p. 25. See also, State Farm v. Schlossberg, 82 Md. App. 45 (1990). So, in the above example, the damages are \$5,000.

Can the insured get damages for emotional injury? After all, the insured had to sit through the trial and await the verdict. It was nerve wracking. While not decided in Maryland, see, Emotional or Mental Distress as an Element of Damages for Insurer’s Wrongful Refusal to Settle, 57 A.L.R. 4<sup>th</sup> 801 (1988).

Can the insured get punitive damages? No. Not after Owens-Illinois v. Zenobia, 325 Md. 420 (1992) unless the insured proves “actual malice” on the part of the carrier to the insured.

### IV. Death, bankruptcy, or other inability to pay of insured

According to Sweeten, supra, the fact that the insured died did not mean that there was no cause of action. In Medical Mutual v. Evans, supra, the court rejected any attempt to suggest that the insured’s inability to pay the excess makes any difference. In Evans, the Court makes clear that the measure of damages is mathematical. It is the difference between the judgment and the policy limit. That is, it is the “excess”. See Kremen v. Maryland Automobile Insurance Fund, 363 Md, 663 (2001).

In Kremen, the underlying defendant, Jones, was insured by MAIF. Plaintiff indicated that he would accept the policy limit of \$20,000, but MAIF would not agree to pay it. Meanwhile, the Plaintiff had an underinsured motorist policy with another carrier in the amount of \$50,000. The jury rendered a verdict in the amount of \$82,882. Jones filed for bankruptcy, and his trustee, Kremen, brought suit in his capacity as trustee against MAIF. The accusation against MAIF was, among other things, that it failed to engage appropriate experts for Mr. Jones. The bankruptcy case was a “no asset” case. That is, if Mr. Kremen were unsuccessful, there would be no assets in the bankruptcy estate, and the judgment in excess of \$20,000 against Mr. Jones would have been discharged. He would have owed no money. Yet, despite this, the bad

faith claim was valid.

Suppose the insured dies after the motor vehicle accident, and no claim is made against the estate within the 6 month period for such claims under Estates and Trusts Article, 8-103.. Under 8-104, if a claim is made thereafter, it is not barred to the extent of available liability insurance. See, Greentree v. Fertitta, 338 Md. 621 (1995). So, the insured/deceased had a policy of \$30,000. The Estate has no assets (like the bankruptcy estate in Kremen). The claim is limited to the amount of the insurance under 8-104. The carrier refuses to pay policy limits and the verdict is \$130,000. The carrier's evaluation of the case was wanting. Does the estate of the tortfeasor, which had no assets, have a potential bad faith claim against the insurer?

There is no Maryland case on exactly this point of which I am aware. In fact, in American Mutual v. Bittle, 26 Md. App. 434 (1975), the court was presented with this question, among others, and decided the case on other issues. That court said, "We do not reach the question whether the absence of proof of monetary loss to the estate of Frazier would operate to bar recovery by the administratrix of his estate." Bittle, p. 441. Since the duty arises from the contract of insurance and the duty is not to jeopardize the insured's assets, but the insured had no assets to jeopardize, one could argue there is no claim. The argument is bolstered by the statute of 8-104(e)(2)(ii), which states that "The amount of the judgment that is recoverable from the estate is limited to the amount of the decedent's liability insurance policy." If that is the case, then how could the insurer jeopardize the assets of the estate when they were never in jeopardy at all? As noted, this is an open question.

#### V. The Bad Faith Letter

The duty to settle a claim within policy limits if possible is a duty that the insurer owes its insured, and with it is the duty to properly investigate, adjust and defend the claim. It really is unimportant to the existence of the duty whether a "bad faith" letter is written. However, the bad faith letter becomes Exhibit 1 in the bad faith claim, and this is the real reason why the letter should be written. Since the bad faith letter will be in evidence, check it repeatedly for typographical errors, grammatical mistakes, and factual precision.

The letter should emphasize the strong liability evidence and the evidence of substantial damages. It should read like a compelling closing argument. It should set forth the fact that the carrier has had ample opportunity to fully investigate the matter, and it should contain a clear statement of a willingness to settle within policy limits. Typically, it includes a date upon which the offer of policy limits must be tendered, and that date should be sufficiently in the future for the carrier to receive, review and consider the policy limits offer.

As an example, the "bad faith letter" could say:

Dear Defense Attorney:

As you know, a horrible accident occurred on April 19, 2006 solely due to the negligence of your insured. There really is no question as to your insured's negligence. She crossed the center line while drunk, striking several parked vehicles, and then struck the vehicle driven by my client, Fred \_\_\_\_\_, M.D. Both vehicles were completely destroyed in the crash.

Dr. \_\_\_\_\_ was taken by ambulance to the Emergency Room of the hospital. He was met in the Emergency Room by his wife of 25 years, whom he had called from his cellphone in the ambulance. Together they awaited the x-ray results which, unfortunately, demonstrated a severely fractured foot. The fracture required two surgeries, the placement of metallic hardware in the foot, and a lengthy convalescences, which included physical therapy, home health care and required Dr. \_\_\_\_\_ to miss 3 months from his active employment, and an additional month wherein he was able to go into the office to catch up on paper work, but not to actually stand and examine patients. While he has now returned to work full time, he has residual difficulties which have decreased his mobility and it is now impossible for him to enjoy his hobbies of golf and tennis. Dr. and Mrs. \_\_\_\_\_ had to cancel a planned vacation to Switzerland, where they were to enjoy hiking and where they were to celebrate their 40th anniversary in the Alps near Zurich. Of course, Maryland law permits a party injured through the negligence of another to recover for economic losses and non-economic losses as well, the latter including damages for pain, suffering, inconvenience, physical impairment, disfigurement, loss of consortium, and other nonpecuniary injury, all of which are present in this case. The prospect of future surgery and the onset of arthritis in the foot is documented in the reports of the treating doctor, Dr. \_\_\_\_\_, who has indicated that Dr. \_\_\_\_\_ has a 25% permanent impairment of his foot and ankle. His treating physician described the fracture, in the operative report, as "horrific". In 30 years of practicing law, I have never seen that word in an operative report.

I have submitted the following economic losses to you:

Hospital	.....	\$ 14,696.79
ER Physicians	.....	\$ 291.00
etc.		
etc		
etc		
		_____
<b>TOTAL MEDICAL BILLS -</b>		<b>\$ 56,927.92</b>

Due to his inability to work Dr. \_\_\_\_\_ incurred an additional \$45,000 of income loss, according to the report from his accountant, Mr. \_\_\_\_\_.

You have taken the Plaintiff's deposition, and that of his wife. You have not yet had a medical examination, and the discovery deadline has passed.. You have disclosed in your Answers to Discovery that your client had a \$250,000/\$500,000 policy in effect at the time of the occurrence.

Dr. \_\_\_\_\_ has authorized me to demand in settlement of this case the policy limit of \$250,000 in settlement of his case, provided that the settlement is paid no later than one week prior to the pre-trial conference, scheduled for \_\_\_\_\_. Thereafter, the offer of settlement should be regarded as withdrawn. If an agreement to settle is reached, the funds will have to be paid within 2 weeks of the settlement date. If the offer is not accepted, we will

proceed to trial and when the verdict is returned in excess of the balance of your policy, we will proceed to execute on your client's assets.

I am not willing to discuss a settlement of less than policy limits. This case is pending in \_\_\_\_\_ County. There have recently been several large verdicts in this county in cases that are similar to the case of Dr. \_\_\_\_\_ .

I do not know what procedures your insurance company uses to evaluate cases. I don't think it makes much difference because the case is clearly worth in excess of the policy limit based upon my review of other verdicts in this jurisdiction and my conversations with my colleagues. In order to facilitate your obligation to keep your insured advised of the progress of settlement negotiations and of his own personal exposure should the case not be settled within the policy limits, I am enclosing a copy of this letter so that you may forward the same to your insured. I await your response by the time deadline set forth above.

#### VI. Possible defenses to the bad faith claim

As noted, payment of the entire verdict bars the claim. So, in the example above, if the policy limit is \$30,000 and the verdict is \$130,000, and the carrier makes payment to the plaintiff in the amount of \$130,000, then there is no bad faith claim any longer, as there are no damages.

It seems obvious that if there is no coverage, there can be no bad faith claim. Wolfe v. Anne Arundel County, 135 Md. 1 (2000). In this case, the County refused to settle a case where a police officer raped a victim; ultimately, this act by the officer was held to be outside the scope of employment. Therefore, the County had no obligation to indemnify the officer, and could not be charged with the failure to settle within its exposure limits.

A wonderfully illustrative case of a defensible bad faith case is American Mutual v. Bittle, 26 Md. App. 434 (1975). I suggest you read it to see what a plaintiff's attorney should NOT do. As noted above, an insurer must have a reasonable opportunity to investigate the case. In Bittle, the policy limit demand was made, and a deadline set, before the carrier had a chance to interview an investigating police officer in a case where liability was at issue. In fact, the deadline was before the institution of litigation. The Plaintiff's attorney refused to permit a medical examination by a physician chosen for this task by the Defendant. The insured never demanded that the carrier settle within policy limits.

In addition, where an insurer evaluates liability fully, has appropriate experts review the matter, keeps its insured informed, and responded reasonably to offers, the mere fact that the verdict exceeds the offer doesn't mean that there is a valid bad faith case.

There could also be a situation where the judgment was a significant aberration from the norm that no reasonably prudent carrier would have made that offer. Let's say you have a case which you have discussed with your client and with colleagues. You believe that a reasonable verdict would be \$50,000, and you demand \$75,000. The policy limit is \$100,000. You have thus clearly indicated that you will accept an amount within the policy limit. The carrier offers

\$45,000 two months before trial, and you turn it down thinking that more will be offered, countering with \$65,000. There is no further offer. At trial, you put on a good case and in closing argument you ask for \$100,000. The jury, to everyone's amazement, renders a verdict of \$400,000. You didn't think the verdict was going to be more than \$100,000. The Defendant didn't think so. None of your colleagues thought so. Is it an excess judgment? Of course. Is there bad faith? Maybe not.

#### VII. - Discovery in the bad faith case.

Of course, you'll want to look at the claims file and all of the correspondence between the defense lawyer and the underlying defendant. But, isn't that privileged? The privilege belongs to the underlying defendant/client, who by this time has assigned his claim to your client, and has waived the privilege.

You will want to look at the policy, underwriting files and guidelines, claims manuals and guidelines, the claim file, including correspondence between counsel and carrier, advertisements and promotions. (You're in good hands?).

You will want to look at documentation of reinsurance, the reserve data for this claim and similar claims. You will want to look at internal memoranda, analyses, and organizational data of the insurer. You will want to look at policies relating to bonuses for claims adjusters. Of course, you will want to look at the carrier's claim experience with other claims, suits, settlements and judgments in like cases in that jurisdiction. You will want to look at computer programs such as Colossus, or any formulas or documents that the carrier has relating to claims evaluation.

The carrier will not want you to see any of this. But, since it is discoverable, there is some likelihood that the bad faith claim will settle before you see any of this.

#### VIII: Jury Instructions

Pattern instructions are located in the Maryland Pattern Jury Instructions, 14:10. Of course, the instructions need to reflect the evidence and should be tailored to do so.

#### IX- Excess insurers vs. primary insurers

Let's say that the defendant in your case has a liability policy of \$50,000. Your client has an Underinsured Motorist policy (UIM) in the amount of \$250,000. Thus, the UIM carrier has potential exposure of \$200,000 (see Insurance Article §19-509 and cases cited thereunder). You indicate in a timely fashion your willingness to settle in full for \$50,000. You send a copy of your demand letter to the underlying carrier with a copy to the UIM carrier. At trial the Plaintiff gets a verdict of \$100,000. The underlying carrier pays you \$50,000 and the UIM carrier pays you \$50,000. The Plaintiff's judgment is paid. The UIM carrier gets a judgment in the amount it paid, \$50,000, on its cross-claim against the tortfeasor.

Question: Does the UIM carrier have a "bad faith" claim for \$50,000 against the



underlying carrier? The answer appears to be that it does not, because the bad faith claim arises from the contract of insurance between the tortfeasor and his insurer. However, in Fireman's Fund Insurance Co. v. Continental Insurance Co., 308 Md. 315 (1987) the Court of Appeals held that the primary insurer may be liable to the excess insurer under the theory of "equitable subrogation." That is, if the tortfeasor's carrier had the opportunity to settle with the Plaintiff for \$50,000, and did not do so, the only reason the UIM carrier has to pay anything is due to that refusal. If the primary insurer engaged in bad faith negotiations, or failed to properly investigate the case, then the excess insurer stands in the shoes of the insured and has the same claim the insured would have had.<sup>4</sup>

Therefore, you may wish to consider in such a case asking the UIM carrier to put pressure on the primary carrier to settle within policy limits. It costs the UIM carrier nothing to do so, and, it may be substantially easier for the UIM carrier to recoup its payment from an insurer, than from an impecunious tortfeasor.

#### X. Conclusion

It is hoped that his article sheds some light on the third party bad faith claim, its history, basis, and some practical aspects relating to the claim.

Irwin E. Weiss

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<sup>4</sup> Thanks to Charles Matz for this citation.