Reverse Bad Faith Claims

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"Reverse Bad Faith" Claims

Overview

"Reverse Bad Faith" refers to a cause of action allowing an insurer to assert a claim for affirmative relief against an insured who acts improperly in the claim handling process. Most states recognize claims and remedies for the insured – sometimes very broad – for improper claim conduct. Should insureds also be subject to liability for their misconduct?

Proponents argue that an insurance company should have a cause of action against a policyholder for "reverse bad faith" where: (1) an insured owes the insurer a duty to act in good faith (whether statutory, common law, or contractual); (2) the insured acts or fails to act in a way that would be bad faith if committed by an insurer; and (3) the insured's act or failure to act prejudices the insurer, usually by interfering with the insurer's adjustment, investigation, defense, or settlement of a claim

On the whole, this cause of action has gained little traction, and published decisions applying or citing the specific term "reverse bad faith" are few.

This paper summarizes the arguments made on both sides of this issue, and discusses the few published decisions in which courts have addressed whether and when to allow reverse bad faith claims.

Arguments For AND AGAINST reverse bad faith

Proponents of accepting reverse bad faith as a theory point out that insureds generally owe a duty to act in good faith in an insurance transaction (whether statutory, common law or contractual) just as do insurers. They suggest there should be a meaningful way to enforce that duty. They argue that the insurer's ability to simply deny the claim is an insufficient deterrent for reverse bad faith because the potential rewards for engineering excessive or undeserved claim payments are so high. They also point out that misconduct by the insured during the claim handling process can cause real damage when it interferes with the insurer's adjustment, investigation, defense, or settlement of a claim and causes the insurer to incur increased costs or fees, or where it causes the insurer to pay more than it should. This, they point out, ultimately harms the entire insurance-buying public in the form of increased premiums and coverage restrictions. Finally, they rely on basic fairness to argue that a remedy such as bad faith should not be available to one party to a contract but not the other.

Opponents of adopting "reverse bad faith" as a cause of action claims argue that insurers already have a powerful tool to use against policyholders in the form of keeping their premiums but not paying their claim. They also contend that insurer bad faith law developed primarily as a counterbalance to insurers' undue leverage during the claim handling process – so reverse bad faith claims or even the threat of them would upset the delicate balance courts have sought to achieve. In this regard, they

point out that insurers could over-use such a tool to create a chilling effect on legitimate coverage and bad faith claims by policyholders who are unwilling or unable to risk their own liability. They also note that adequate remedies for policyholder misconduct already exist -- in the form of the "cooperation" clause in most insurance policies as well as insurance fraud statutes that exist in many states. Finally, they argue that there is no real evidence of claim handling abuses by policyholders that are not sufficiently addressed by existing remedies.

A survey of noteworthy cases on the issue

Hartford Roman Catholic Diocesan, Corp. v. Interstate Fire and Cas. Co., 199 F.Supp.3d 559 (D. Conn. 2016) (internal citations omitted). "[W]hile Connecticut… recognizes that every insurance policy carries an implied duty requiring that *neither* party do anything that will injure the right of the other to receive the benefits of the agreement, no Connecticut court has recognized the tort of 'reverse bad faith' against insureds…"

XTO Energy, Inc. v. ATD, LLC, No. CIV 14-1021 JB/SCY, 2016 WL 173071 (D. New Mexico, Apr. 1, 2916). "Comparative bad faith is an affirmative defense doctrine…whereby a defendant to a tort bad faith action can assert that the plaintiff's own bad faith contributed to the damage, thereby reducing or barring a judgment… Although no case law is directly on point, commentators have suggested that a comparative bad-faith defense may be applicable where an insured breaches the

cooperation clause in an insurance policy and thereby prejudices the insurer."

State Auto Prop. And Cas. Ins. Co. v. Hargis, 785 F.3d 189 (6th Cir. 2015). "A common law tort claim for reverse bad faith has not been recognized in any jurisdictions, although it is true that only a handful of jurisdictions have addressed the issue."

Prasad v. Am. Fam. Mut. Ins. Co., No. C10-762Z, 2010 WL 11565188 (Sept. 1, 2010 W.D. Wash). "There are no Washington cases that have decided whether an insurer may maintain a claim for reverse bad faith against an insured. However, the trend of authority in other jurisdictions suggests a claim is not favored."

Kransco v. Am. Emp. Surplus Lines Ins. Co., 23 Cal.4th 390, 97 Cal.Rptr.2d 151 (2000) (quoting *Agricultural Ins. Co. v. Sup. Ct.*, 10 Cal.App.4th 385, 82 Cal.Rptr.2d 594 (1999)). "'An insurer has no claim against its insured in tort for breach of the covenant of good faith and fair dealing…. A relationship including specialized circumstances of reliance and dependence is necessary to transmute such a contractual breach into a tort. Such circumstances do not exist in the context of an insured's responsibilities toward its insurer, or in the reciprocal context of an insurer's legitimate expectations from its insured. Although a false claim by an insured might trigger adverse contractual or penal consequences, the obligations undertaken by an insured in entering into an insurance contract are simply not of the same character as the obligations undertaken by an insurer. Hence an insured does not bear a risk of affirmative tort liability for failing

to perform the panoply of indefinite but fiduciary-like obligations contained within the concept of 'insurance bad faith.'"

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