The Legal Intelligencer
THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2022
PHILADELPHIA, JULY 26, 2022
ALM.

# Practice Tips for Litigating Third-Party Bad Faith Insurance Claims

**BY MARK W. TANNER AND PETER M. NEWMAN**

Third-party bad faith claims typically arise from a common fact pattern: an insured defendant, hit with an excess verdict because his insurer refused to make a reasonable settlement offer, assigns to the plaintiff the right to bring a bad faith claim against the insurer.

Indeed, it is well-established in Pennsylvania that an insurer breaches its contractual duty to act in good faith, and its fiduciary duty to its insured, when it refuses to settle a claim that could have been resolved within the policy limits, unless the insurer has "a bona fide belief … that it has a good possibility of winning." See *Birth Center v. St. Paul Companies,* 787 A.2d 376, 379 (Pa. 2001), quoting *Cowden v. Aetna Casualty & Surety,* 134 A.2d 223, 229 (Pa. 1957). Pennsylvania's bad faith statute, 42 Pa.C.S.A. Section 8371, authorizes special damages if a court finds that an insurer acted in bad faith.

Yet, notwithstanding the commonality in fact pattern and settled law, third-party bad faith claims are not a slam-dunk, and like all litigation, they require a thoughtful and planned approach. While not meant to be exhaustive, below are practice tips for prosecuting this distinct type of claim.

Courtesy photos

**Mark W. Tanner,left, and Peter M. Newman,right, of Feldman Shepherd**

## Gathering the Evidence

Not every excess verdict gives rise to a meritorious bad faith claim. Counsel's first step must be to fully investigate and consider the facts carefully. To obtain a complete copy of the litigation file from the underlying case, counsel should obtain from the insured a waiver of the attorney-client privilege, and should meet with the insured to prepare an affidavit setting forth all facts that support a bad faith claim.

Note that in Pennsylvania there is no direct cause of action for a third-party claimant against the insured's carrier. Pursuant to *Gray v. Nationwide Mutual Insurance,* 223 A.2d 8 (Pa. 1966), the insured may assign his rights against his carrier to the claimant. Most insureds will happily oblige in exchange for an agreement by the claimant not to enforce the excess judgment against the insured's personal assets.

## Issues to Consider

Two important issues to consider in evaluating the evidence are: Did the plaintiff make a demand within the policy limits? Did the insured defendant consent to settle the underlying case?

As bad faith cases hinge upon the ability to establish that the insured could have been protected from an excess verdict in the underlying action if the insurer had acted

in good faith, it is important to obtain documentation of all settlement demands. While neither the Pennsylvania Supreme Court, nor any court interpreting Pennsylvania law, has ever held that a demand to settle within the policy limits is a condition precedent to a finding of bad faith for an insurer's failure to settle, the best practice is for the plaintiff to make a demand for the policy limits at some point prior to trial.

In cases where the insurance policy contains a "consent to settle" clause, it is important to determine whether the insured gave or withheld consent. In Pennsylvania, nonconsent to settlement by an insured is a defense to bad faith pursuant to *Puritan Insurance v. Canadian Universal Insurance,* 775 F.2d 76 (3d. Cir. 1985). However, there are circumstances where bad faith can be established even when the insured withheld consent to settle.

For example, our firm successfully litigated a third-party bad faith case in the context of an underlying medical malpractice action where a doctor and his practice had a combined $2.4 million in primary and excess coverage. The doctor withheld his consent to settle and was subsequently hit with a verdict that exceeded his total coverage by more than $13 million. We argued that the insurer withheld critical information from the doctor, and had the doctor been fully informed, he would have given his consent to settle. The information withheld included:

- The plaintiffs had offered to settle the claim prior to trial for his policy limits;
- The doctor could consent to settle without admitting liability;
- The plaintiffs had proposed a high/low arbitration where the doctor could still defend himself, without risking his reputation at a public jury trial, and while also protecting himself against personal exposure and huge financial risk; and
- Expert witnesses retained by the insurer raised significant concerns with respect to liability and assessed that the doctor had only a 60 percent chance of winning at trial.

**Deposing the Claims Adjuster**

The importance of deposing the claims adjuster cannot be overstated.

In another bad faith case we litigated, the doctor in the underlying medical malpractice case had given his insurer his consent to settle, but the insurer had refused to offer more than $50,000 of its $200,000 primary policy. A jury ultimately awarded the plaintiffs $2.5 million in damages, which was far in excess of the doctor's coverage.

When questioned at deposition as to why the insurer refused to offer more than $50,000, the claims adjuster revealed that he was pursuing a risky negotiation tactic wherein he hoped to scare an insurer for another party into contributing additional money to settle the case. The adjuster admitted at deposition that his strategy was unreasonable and that it prevented the case from settling.

This scheme, of course, was in the insurer's own self-interest and was a clear violation of its contractual duty to its insured.

**Required Experts**

While expert testimony is not required to prove bad faith, we invariably retain experts in one or more of the following categories:

**Defense attorneys with significant experience handling claims similar to the underlying claim giving rise to the bad faith action.** For example, in the two bad faith cases discussed above, we retained attorneys who had represented physicians and hospitals and, therefore, had extensive experience working with insurers. One of those attorney experts had also served as coverage counsel for primary and excess insurers and had experience teaching insurers about claims handling practices. The issue we asked the attorney experts to address was whether the insurer's settlement negotiation strategy demonstrated reckless disregard for the best interests of its insured, or whether the insurer acted in a manner adverse to the interests of its insured by refusing to tender its primary policy or by refusing to enter into a high/low agreement to protect its insured from an excess verdict.

**Former insurance claim representatives, supervisors, and managers.** These insurance

insiders can assist the jurors, without offering an opinion as to the ultimate issue, by testifying about the defendant insurer's claims-handling practices and the extent to which those practices conformed to industry norms. Pennsylvania courts have routinely permitted such expert testimony in bad faith cases. See e.g., *Leporace v. N.Y. Life & Annuity,* 2014 WL 772366 (E.D. Pa. May 7, 2014); *Allstate v. Vargas*, 2008 WL 4104542 (E.D. Pa. Aug. 29, 2008); *Monaghan v. Travelers*, 2014 WL 3534573 (M.D. Pa. Jul. 16, 2014); *Gallatin Fuels v. Westchester Fire Insurance,* 410 F.Supp.2d 417 (W.D. Pa. 2006).

**Recoverable Damages**

For the plaintiff who prevails on a third-party bad faith claim, the unpaid excess verdict is recoverable. Pennsylvania's bad faith statute, 42 Pa.C.S.A. Section 8371, also provides that the court may award the following special damages:

- Interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
- Punitive damages against the insurer.
- Court costs and attorneys' fees against the insurer.

With respect to punitive damages, in 2017, the Pennsylvania Supreme Court held that punitive damages may be awarded pursuant to Section 8371 simply upon a finding of bad faith, without further proof that the insurer had a motive of self-interest or ill-will. See *Rancosky v. Washington National Insurance,* 170 A.3d 364 (Pa. 2017). The *Rancosky* court also formally adopted the two-part definition of bad faith first articulated by the Superior Court in *Terletsky v. Prudential Property & Casualty Insurance*, 649 A.2d 680 (Pa. Super. 1994), namely that there must be clear and convincing evidence that the insurer lacked a reasonable basis for denying benefits under the policy and that the insurer knew of, or recklessly disregarded, its lack of a reasonable basis. The bad faith statute therefore creates an exception to the general rule in Pennsylvania that punitive damages are recoverable only when the defendant's conduct is "outrageous," defined by the Restatement (2d) of Torts, Section 908 as conduct that is malicious, wanton, willful, reckless or oppressive. Punitive damage awards are subject to constitutional limits defined by the U.S. Supreme Court in *BMW v. Gore,* 517 U.S. 559 (1996) and *State Farm v. Campbell,* 538 U.S. 408 (2003). The Supreme Court established "guideposts" for assessing punitive damage, holding that few awards exceeding a single-digit ratio between punitive and compensatory damages will satisfy due process. When considering the proportionality of punitive damages to compensatory damages, a court must include attorney fees, costs, and interest in the calculation of compensatory damages. See *Willow Inn v. Public Service Mutual Insurance*, 399 F.3d 224 (3d Cir. 2005).

**Final Thoughts**

Insurance exists to protect the insured from financial harm resulting from the insured's negligent conduct. However, in some circumstances, when the insured seeks that protection in an effort to provide compensation to those that have been injured, and the insurance company unreasonably refuses to honor its obligations, then a third-party bad faith claim is the only remaining vehicle by which the true wrongdoer can ultimately be held responsible. Sometimes the verdict in the personal injury case is just the mid-point, and not the end, of the litigation.

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