BAD FAITH BASICS

Flipping the script and mediating an insurance bad faith claim early—even before the underlying tort case is resolved—can be the most efficient option. Here's an overview of what to do before you walk into the mediation room.

By || **Fred Cunningham**

In my experience, insurers handle the overwhelming majority of claims in good faith. When they do not, however, the consequences for their policyholders can be catastrophic.

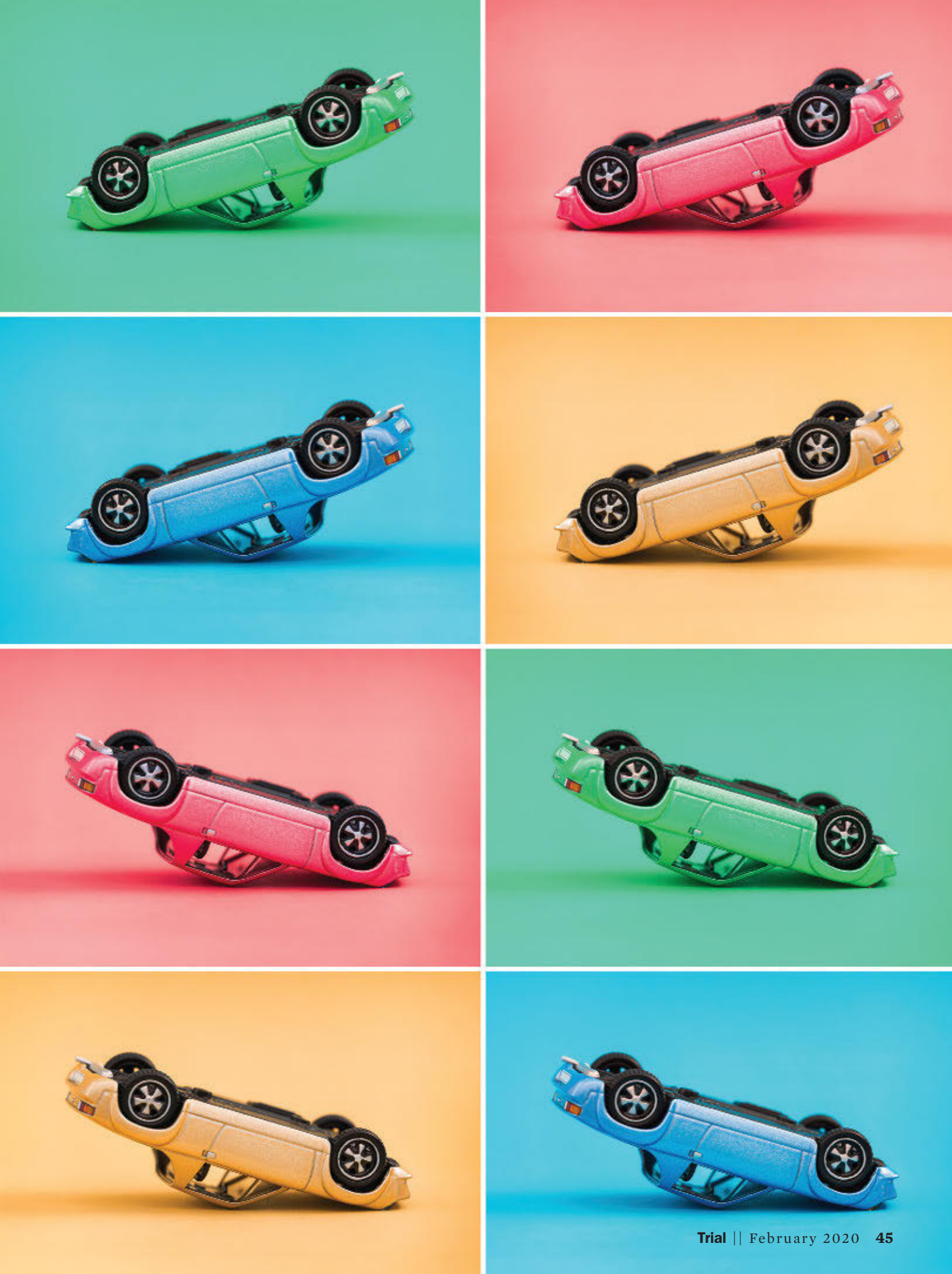
Simply stated, insurance bad faith (IBF) is insurer malpractice. Just like lawyers, doctors, and drivers, insurers must adhere to certain standards, and when they fail to do so, the policyholder, third-party claimant, or both may have an IBF claim. The standards can be imposed by statute, the common law of the particular state, or both.

In almost every state, courts require the parties to mediate an IBF claim before allowing the IBF case to proceed to trial.[1] In many ways, mediating IBF claims is identical to mediating any other claim, but there are some specific considerations for a successful outcome.

Policyholders, as insurance customers, may bring first-party claims that they are entitled to the benefits of the insurance policy—these first-party claims include uninsured/underinsured motorist claims, homeowners insurance claims, and health insurance claims. By contrast, a third-party claim is one in which the insurance policy proceeds are intended to benefit an injured third party, not the policyholder. The typical automobile crash claim is the most common example of a third-party claim. Your approach to mediation should be the same, regardless of whether the IBF claim is a first-party or third-party claim: You are seeking to have the insurer pay money above the policy limits selected by the insured. Your approach should be the same, because your objective is the same—to obtain the full value of your client's claim, regardless of the amount of the policy limits.

Timing Is Everything

Insurers traditionally waited until there was an actual, accrued IBF case before mediating—which was typically after a final judgment in excess of the policy limits was



entered against its insured and affirmed on appeal. In that scenario, the parties would litigate the IBF case for many months before reaching a resolution.

Recently, however, prudent insurers are more willing to mediate IBF cases before they have accrued. Instead of waiting until an excess judgment has been entered against the insured and affirmed on appeal, insurers are mediating the IBF case before the trial of the tort case. Your goal in such a prejudgment mediation is to settle the tort case and the unaccrued IBF case at the same time and for a sum above the policy limit.

Why would an insurer voluntarily agree to pay out over the policy limits long before an excess judgment has been entered against its insured, much less affirmed on appeal? Prudent insurers realize that litigating and appealing the underlying tort case and then doing the same for the IBF case is time-consuming and expensive. Your reasons for doing so are equally compelling: Consider whether it's a better outcome for the client to settle the case early before having to jump over the first of the four hurdles involved in a typical excess resolution.

To convince an insurer to mediate an unaccrued IBF case along with the underlying tort case before that tort case is even tried, we use a time-tested letter that we ask the plaintiff's tort counsel to send to the insured's attorney. The letter specifies that the plaintiff has rejected the insurer's offer of policy limits because he or she believes the insurer has acted in bad faith. Next, the letter lays out the options: The parties can pursue the "traditional route," which means trying the tort case, handling the appeal, and then litigating the IBF case and its appeal. Or they can enter into a consent judgment to end the underlying tort case, to be followed by litigation of the IBF case.

The letter points out that the first route is time-consuming and expensive, while the second option would save the parties a lot of time and money by obviating the need for the tort trial and the appeal of the tort judgment. Then it proposes an even more cost-effective and time-effective option: simultaneously mediating the tort case and the IBF case. The letter should advise the insurer that the plaintiff has already retained IBF counsel and encourage the insurer to do so as well. This technique can be used in first-party claims too.

Use the deposition to uncover the shortcomings of the insurer, which doomed the adjuster to fail through lack of proper training or assigning too many files.

Prejudgment Considerations

Prejudgment mediation of the IBF case can be a little more challenging if you step in as IBF counsel at this stage because you will not have the insurer's claims file, as you would if you were mediating the IBF case in the traditional manner. Although you will not be aware of *exactly* what occurred in the handling of the tort claim, correspondence between the plaintiff's tort counsel and the adjuster or defense counsel usually will shed enough light on why the case did not settle. In my opinion, not having the claims file is not a sufficiently strong reason to wait to mediate. Typically, even though you will not know everything the insurer did or did not do, you will know enough to convince the insurer that it has acted in bad faith.

In a prejudgment mediation, work with the plaintiff's tort counsel to prepare an exposure chart that shows the insurer

- the financial exposure it faces based on the estimated final judgment in the tort case
- the defense costs of the tort case
- the costs of appealing the tort judgment (including interest that will accrue on the tort final judgment during appeal)
- the costs of litigating the IBF case (including defense costs and interest that will accrue on the tort final judgment during the IBF case)
- the costs of the IBF case appeal.

This financial exposure adds up very quickly as the case progresses through the typical stages, which is all the more reason for the insurer to settle quickly and avoid the inevitable cost of years of litigation that may prove to be unsuccessful.

The total financial exposure largely depends on the number used for the estimated final judgment in the tort case. The number should be realistic and credible—ideally, it should fall within the verdict range that the defense counsel is providing to the insurer.

If you cannot convince the insurer to attend a prejudgment mediation to

PREVIOUS SPREAD AND THIS SPREAD: INTARAPONG/SHUTTERSTOCK

attempt settling the tort case and the IBF case, you can still mediate the IBF claim. Mediation remains a good option after the tort trial concludes, after final judgment has been affirmed on appeal, and after you have conducted discovery in the IBF case—the insurer can still save considerable time and money by settling before potentially losing the bad faith trial and pursuing an expensive, time-consuming appeal.

Discovery

Whether mediating an IBF case before or after the tort case is resolved, basic discovery rules apply.

Claims file. In IBF cases, this is almost always the most critical evidence because it's the map of how the insurer handled the case. Most often, what is in the file is extremely important, but sometimes, what is *not* in the file can be even more crucial. For example, if the plaintiff's tort counsel has documented an important phone call with the adjuster, the absence of documentation of that phone call in the claims file could be crucial. Request the entire claims file, with the exception of any prejudgment communications between the insurer and IBF counsel. This includes all of the insurer's local and regional office claims files, as well as any home office claims files.

Although you likely won't find much in the home office files that is not also contained in the local and regional office files, it's still good practice to discover all of these. You never know exactly what will be in a home office file, and you just might get a very welcome surprise. Sometimes, the files are combined into one.

Additionally, obtain the insurer's claims handling manuals and any guidelines that were in effect while the tort claim was pending. These manuals can be a treasure trove of valuable information. Insurers typically try to be as detailed as possible when teaching their adjusters how claims should be handled. Often, it is easy to show a deviation from how the insurer taught its adjusters to handle claims.

For example, in many IBF cases arising out of automobile crashes, the bad faith occurs because the insurer does not fully investigate the liability and damages aspects of the claim. Every claims manual I have seen instructs the adjuster to perform a full investigation of liability and damages. Start questioning the adjuster with the instructions in the claims manual that require a full investigation, then follow up with all of the specific ways in which a full investigation was not completed in your client's case.

E&O coverage. Determine whether the insurer has any coverage for its own errors and omissions (E&O). In my experience, it can be easier to settle an IBF case when the defendant has coverage for its bad faith conduct. But often, large insurers will pay any IBF claims themselves.

Some insurers have a self-insured retention before an E&O policy kicks in. A large insurer may have to pay the first $1 million or more before the E&O policy kicks in. An insurer with a self-insured retention that exceeds what is needed to settle your client's IBF case may be less willing to settle. Insurers also may have reinsurance or traditional E&O policies. However, large insurers may not have reinsurance or E&O policy coverage and may need to pay your claim out of their coffers—making them more reluctant to settle. Before proceeding to mediation, you must know what entity ultimately will be paying your client's claim.

Depositions

After receiving discovery responses, depose everyone who may have material knowledge of how the underlying claim was handled. The claims file will give you the name of every person who handled the file, from the first intake phone call through the resolution of the claim. In some IBF cases, the claims file is thousands of pages long—review every page before you take the first deposition.

Focus on the adjuster's failure to protect the insured, since that is the essence of an IBF claim. You do not want your questioning to engender sympathy for the adjuster, as most adjusters are overworked. Blame the insurer for the adjuster's failures, not the adjuster. Use the deposition to uncover the shortcomings of the insurer, which doomed the adjuster to fail through lack of proper training or assigning too many files.

The following are some of the typical questions asked of the adjuster (Let's assume the insurer is Theta Co.):

1. Have you heard the term "fiduciary duty"? (Often, the answer is "No," which is a problem for the insurer.)
2. Would you agree that Theta Co. owed a fiduciary duty to its policyholder in this situation?
3. What does fiduciary duty mean to you as an adjuster for Theta Co.? (Some adjusters answer correctly, but many don't.)
4. Did you ever perform any type of risk analysis as to the value of the claim against your policyholder? (It is surprising, but the answer is often "No.")

Finally, after questioning the adjuster about every failure, ask the following final question: Do you believe that Theta Co. gave its policyholder the treatment she was owed under the policy she purchased? As you can imagine, there is no good answer for the insurer. If the adjuster's answer is yes, the answer appears absurd in light of the prior testimony. If the answer is no, you have an extremely powerful admission.

An inherent difficulty of handling IBF cases is that the defendant is usually more antagonistic than in a typical tort case. No professional likes being accused of

malpractice, and insurance adjusters are no exception. Moreover, in some cases, the adjuster's job may be on the line if IBF is proven.

For this reason, I strongly advise videotaping the depositions. In every IBF case I have handled, I've used video excerpts of the adjuster's testimony during the mediation.

Mediation

Once discovery and depositions are concluded, the next step is to prepare for the actual mediation.

Mediation summary. Draft a very detailed mediation summary, and provide a copy of it to defense counsel. The summary should contain a thorough analysis of the deposition testimony that has been taken and lay out every reason why jurors will side with your client at trial. My philosophy is to give defense counsel and the insurer my best arguments and challenge them to figure out how they could overcome them.

PowerPoint. I almost always prepare a very detailed PowerPoint to present at mediation. I incorporate deposition testimony, often in the form of video clips, into the presentation. Try to present the clips that are the absolute knockout punches. Do not use too many clips—it will dilute the impact of the most crucial ones.

I usually provide a copy of my PowerPoint to defense counsel and the mediator at least two weeks before mediation. It's ideal to provide this presentation and the mediation summary 30 days prior. I want the decision-makers at the home office to know all of my arguments and to see the crucial deposition testimony long before getting to mediation. With that information, they can be better prepared to decide how much to offer to settle.

While the exact steps in mediating an IBF case will depend on the stage at which your case is mediated, these basic steps and strategies will go a long way toward a successful resolution.

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Note

1. Mediation requirements are contained in standard pretrial orders of trial judges throughout the country. There are no statutory standards per se.