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Douglas R. Richmond

I. INTRODUCTION

All contracts include an implied promise of good faith and fair dealing.¹ Insurance policies, like all other contracts, contain this implied promise or covenant,² usually described as a duty. The implied duty of good faith and fair dealing fundamentally requires that neither party to a contract do anything that will injure the other’s right to receive the benefit of their agreement.³ In the insurance context, then, the duty of good faith and fair dealing is a two-way street, open to travel by insureds and insurers alike. Just as the duty prevents an insurer from taking advantage of its insureds, so too should it prevent insureds from acting unreasonably to their insurers’ ultimate detriment.⁴ In reality, however, the two-way street does not always seem to exist.

Insurance companies are continuously pounded in bad faith cases. In 1996, for example, a Utah jury awarded the plaintiffs in a bad faith case.

¹ See Restatement (Second) of Contracts § 205 (1979).
⁴ See, e.g., Greater New York Mut. Ins. Co. v. North River Ins. Co., 872 F. Supp. 1403 (E.D. Pa. 1995), aff’d, 85 F.3d 1088 (3d Cir. 1996). In Greater New York, the court expressly recognized that the duty of good faith and fair dealing implied in insurance policies is reciprocal. Id. at 1408. Without reaching any conclusion about whether the insured breached the duty in the case at bar, the Greater New York court generally observed that “[a]n insured should not have license to act in bad faith toward its insurer.” Id.

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action $145 million in punitive damages. In 1995, a Los Angeles jury returned an $86,700,000 bad faith verdict in a property damage case, including punitive damages of $57,800,000. Another California jury awarded an insured $20,478,000, including $20,000,000 in punitive damages. In 1994, a California jury returned a $7,150,000 bad faith verdict, including $6,500,000 in punitive damages, when an insurer only partially paid its insured’s $225,000 fire loss claim. A Nevada jury awarded a construction company punitive damages of $30,000,000 for its insurer’s bad faith. A Missouri jury returned a verdict exceeding $8,000,000 against a self-insured car rental company that refused to settle a wrongful death claim for $25,000. In a 1993 case, a health insurer that deemed an insured’s bone marrow transplant “experimental” and refused to authorize the procedure was hit for $12,320,000 in compensatory and $77,000,000 in punitive damages. In another 1993 case, a Texas jury awarded compensatory damages of $2,170,000 and punitive damages of $100,000,000 against an insurer that denied a $20,000 uninsured motorist claim. In 1991, an Alabama court upheld a $750,000 punitive damage award for an insurer’s bad faith denial of a $1,000 claim. Some insurers earn substantial bad faith judgments by virtue of their reckless conduct or insensitive actions. Clayton v. United States Automobile Ass’n is an illustrative case. In Clayton, the insurer, USAA, offered to pay a bereaved father no more than $10,000 under his underinsured motorist coverage in connection with his teenage son’s death. At trial, the boy’s interest in photography was discussed in connection with USAA’s valuation of the claim. The USAA adjuster testified that “although the boy was a photographer, ‘he was no Ansel Adams.’” The jury was apparently angered by the

12. Id.
15. Id.
adjuster’s testimony and responded by awarding the father $3,900,000 in punitive damages.\textsuperscript{16}

Plaintiffs do not win all bad faith cases, of course. Insurers frequently prevail at trial.\textsuperscript{17} Additionally, courts do not always allow outrageous bad faith verdicts to stand. Bad faith verdicts sometimes are reduced or reversed by way of post-trial motions, or on appeal.\textsuperscript{18} Even so, there is no doubt that bad faith claims are a big stick when wielded by aggressive plaintiffs’ counsel, who can use the threat of extracontractual liability to bludgeon insurers into submission.

Insurers’ vulnerability to bad faith claims at trial has not escaped notice:

Bad faith claims are often more financially rewarding for a policyholder and his attorney than simply collecting on the underlying insurance claim. Accordingly, it has become commonplace for plaintiffs’ attorneys to focus their time and energy on maneuvering insurance companies into committing acts that can later be characterized as bad faith.\textsuperscript{19}

Additionally, in recent years, lecturers at continuing legal education seminars have started advising their colleagues on how best to “set up” insurers for bad faith claims. “Bad faith litigation against insurers is a burgeoning cottage industry throughout virtually all of the fifty states.”\textsuperscript{20}

Insurers’ responses to this increasingly hostile judicial environment have included arguments at trial, on appeal, and in industry forums, that they, like other tort defendants, should be allowed to compare their insureds’ fault or bad faith, thus reducing their damage exposure. Insurers have also asserted that they should be allowed to sue their insureds for “reverse bad faith” under certain circumstances.\textsuperscript{21} In

\textsuperscript{16} Id.


\textsuperscript{21} \textit{See infra} Parts IV, V.
other words, insurers believe they should have an affirmative defense in some cases, a counterclaim in other cases, and possibly even both.\textsuperscript{22}

Insurers’ arguments for the application of comparative fault in bad faith cases, “comparative bad faith” and “reverse bad faith,” have drawn a decade of scholarly attention.\textsuperscript{23} However, while scholars have generally championed the adoption of comparative fault and comparative bad faith and, to a lesser degree, reverse bad faith, courts have not been so accepting. In the most recent case on point, the Supreme Court of Iowa rejected a cause of action for reverse bad faith.\textsuperscript{24} Thus, the two-way street of good faith and fair dealing in insurance policies remains for the most part a one-way street; it is at best congested with judicial orange barrels and doctrinal detour signs.

If the duty of good faith and fair dealing is a two-way street under construction, this Article is the equivalent of a progress meeting on-site. It is time to see where the law has been, assess where it is now, and plan where it is going. First, this Article provides a brief background of third-party bad faith\textsuperscript{25} and first-party bad faith causes of action,\textsuperscript{26} with a comparison to contract law.\textsuperscript{27} Next, the Article

\begin{footnotesize}
\begin{enumerate}
\item[22.] See infra Parts V, VI.
\item[24.] Johnson v. Farm Bureau Mut. Ins. Co., 533 N.W.2d 203 (Iowa 1995). But see Adams v. Tennessee Farmers Mut. Ins. Co., 898 S.W.2d 216 (Ten. Ct. App. 1994). In \textit{Adams}, a Tennessee court affirmed a trial court’s entry of a judgment for an insurer in a reverse bad faith case. Unfortunately for insurers, \textit{Adams} is of little (if any) precedential value outside Tennessee. The insurer’s bad faith counterclaim was based on a specific statutory provision granting the insurer a cause of action against the insured. \textit{Id.} at 218.\textsuperscript{37}
\item[25.] See infra Part II.A.
\item[26.] See infra Part II.B.
\item[27.] See infra Part II.C.
\end{enumerate}
\end{footnotesize}
discusses the defenses of the insurer, examining both the insurer's affirmative defense of comparative bad faith and the insurer's counterclaim or separate action of reverse bad faith. The Article then gives some examples of how insureds and insurers may alter their situations, giving rise to comparative bad faith defenses. Finally, the Article concludes that courts need to recognize comparative fault and comparative bad faith as affirmative defenses, as well as the independent claim of reverse bad faith.

II. BACKGROUND

The tort of insurance bad faith is relatively new; it dates back only to the late 1950s, and it was not taken seriously until the 1970s. Bad faith claims may be made in the third-party context (liability insurance) or in connection with first-party policies.

A court formulation of a tort duty of good faith and fair dealing is unremarkable. Insureds purchase their policies for peace of mind and security, rather than for financial gain. An insurer and its insured, unlike parties to typical contracts, share a special relationship. This unique relationship arises out of the parties’ perceived disparate bargaining power and the nature of insurance policies, which potentially allow predatory or unscrupulous insurers to exploit their insureds’ misfortune when resolving claims. The duty of good faith

28. See infra Part III.A-B.
29. See infra Part IV.
30. See infra Part V.A-B.
31. See infra Part V.B.
32. See infra Parts V.C-D, VI.
and fair dealing between insurers and insureds fills the void created by the parties’ unequal bargaining power and insurers’ control over claim processing.  

A. Third-Party Bad Faith

The earliest bad faith cases arose in the third-party context. In 1967, the California Supreme Court held in *Crisci v. Security Insurance Co.* that a liability insurer’s unreasonable refusal to settle a claim within policy limits constituted an independent tort. Today, a tort cause of action for third-party bad faith is widely recognized.


40. Id. at 178.


To fully understand liability insurers’ potential bad faith exposure in the third-party context, it is necessary to understand the three related duties of insurers: the duty to defend, the duty to indemnify, and the duty to settle.

1. The Duty to Defend

Standard liability policy language obligates insurers to defend their insureds even against groundless, false, and fraudulent suits. The duty to defend arises upon the insured’s tender. As a general rule, whether a defense is owed is determined by comparing the petition or complaint with the policy. Several jurisdictions have expanded on what is commonly described as the “eight corners rule,” sometimes requiring the insurer to look beyond the pleadings to determine whether it owes the insured a defense. These jurisdictions properly


view the eight corners rule as an inclusionary standard. In other words, every petition or complaint alleging a covered cause of action gives rise to a duty to defend. The eight corners rule is not a valid exclusionary standard, meaning that the plaintiff's pleaded allegations should not be dispositive of the insurer's defense obligation. This is especially true where the petition or complaint is unclear, resulting in uncertainties about coverage. Indeed, the eight corners rule is seriously undermined by the liberal notice pleading allowed in many jurisdictions.

An insurer's duty to defend is broader than its duty to indemnify. Any question as to whether a defense is owed is always resolved in the

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45. See, e.g., Blackburn v. Fidelity & Deposit Co., 667 So. 2d 661, 668 (Ala. 1995).

46. See, e.g., First Nat'l Bank v. Fidelity & Deposit Co., 545 N.W.2d 332, 335-36 (Iowa Ct. App. 1996). As the court in Aetna Casualty & Surety Co. v. Sunshine Corp., 74 F.3d 685 (6th Cir. 1996), observed:

It is true that the duty of an insurance company to defend its insured is determined by the allegations of the pleading in which the claim against the insured is asserted. But this does not mean that a particular choice of [language] by the draftsman of a complaint against the insured can deprive the insured of its contractual right to an insurer-provided defense in a situation where the plaintiff could recover a judgment for damages against the insured even if the [language] should prove ill-chosen.

Id. at 688 (citation omitted).

insured's favor. An insurer owes its insured a defense if the plaintiff's allegations are even arguably or potentially within the scope of the policy. Even so, an insurer need not defend when no potential for coverage exists under any theory.

2. The Duty to Indemnify and the Duty to Settle

An insurer’s contractual duty to indemnify its insured for a covered loss is not triggered until the insured incurs liability for the underlying claim. The timing of this duty is made clear by standard policy language, which provides that the insurer will “pay those sums that the insured becomes legally obligated to pay as damages.” To protect insureds’ interests in the interim, and to generally shield insureds from financial ruin, courts imply a duty on insurers’ part to attempt in good faith to settle claims for their insureds’ benefit. The implied duty to


52. 1 Susan J. Miller & Philip Lefebvre, MILLER’S STANDARD INSURANCE POLICIES Annotated 409 (1995).

settle thus supplements insurers’ duty to indemnify, although at least one court has labeled it a category of the duty to defend.\textsuperscript{54}

In order to breach its implied duty to settle, an insurer must first be presented with a covered claim. An insurer has no duty to settle a claim or suit that falls outside the scope of its coverage.\textsuperscript{55} Once coverage is established, an insured must be offered a settlement within policy limits. A liability insurer is not obligated to initiate settlement negotiations with a third-party claimant.\textsuperscript{56} If the plaintiff does not make a settlement demand or offer, the insurer cannot breach its implied duty.\textsuperscript{57} Similarly, if the plaintiff’s settlement demand or offer exceeds policy limits, the insurer cannot later be held liable for refusing to settle.\textsuperscript{58}

An insurer is not always obligated to settle a claim within policy limits under penalty of absolute liability for any subsequent excess judgment against the insured.\textsuperscript{59} An insurer’s bad judgment does not
necessarily equate with bad faith. In many cases a vigorous defense is superior to a proposed policy limits settlement. An insurer’s duty to settle does not translate into a unilateral requirement that it pay policy limits upon demand. An insurer may decline to settle a case without incurring subsequent bad faith liability if it reasonably believes that the insured is not liable, or that the plaintiff’s demand exceeds a probable jury award. The insurer must, however, give its insured’s interests the same consideration that it gives its own interests.

3. To Whom Are the Duties Owed?

An insurer’s duty of good faith and fair dealing is fundamentally contractual; it does not extend to every person arguably entitled to payment from policy proceeds. As a general rule, a liability insurer’s duties flow only to its insured; an insurer does not owe a third-party claimant a duty of good faith. Absent a “direct action” statute, a third party cannot sue a liability insurer directly for the company’s alleged bad faith.

B. First-Party Bad Faith

First-party bad faith originated in Fletcher v. Western National Life


65. See Allstate Ins. Co. v. Watson, 876 S.W.2d 145, 150 (Tex. 1994) (articulating conflict of interest theory precluding insurers’ duties to third-party claimants). But see State Farm Fire & Cas. Co. v. Green, 624 So. 2d 538, 539-40 (Ala. 1993) (plaintiff can sue as third-party beneficiary when insurer’s liability is not predicated upon the insured’s liability).
In *Fletcher*, an insurer was held liable in tort for its refusal to honor its insured’s disability policy. Comparing third-party principles with the situation before it, the *Fletcher* court stated:

We think that, similarly, the implied-in-law duty of good faith and fair dealing imposes upon a disability insurer a duty not to threaten to withhold or actually withhold payments, maliciously and without probable cause, for the purpose of injuring its insured by depriving him of the benefits of the policy. We think that . . . the violation of that duty sounds in tort notwithstanding that it also constitutes a breach of contract.67

The California Supreme Court expanded *Fletcher* in *Gruenberg v. Aetna Insurance Co.*,68 which is widely regarded as the landmark first-party bad faith case.69 The *Gruenberg* insurers denied liability for the plaintiff’s fire loss, believing that the plaintiff committed arson in connection with a fire at his cocktail lounge and restaurant.70 Explaining its endorsement of a first-party bad faith cause of action, the court stated:

[In *Comunale* and *Crisci* we made it clear that “[l]iability is imposed [on the insurer] not for a bad faith breach of contract but for failure to meet the duty to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing.” (Crisci, supra, 66 Cal. 2d at p. 430, 58 Cal. Rptr. at p. 17, 426 P.2d at p. 177.) In those two cases, we considered the duty of the insurer to act in good faith and fairly in handling the claims of third persons against the insured, described as a “duty to accept reasonable settlements”; in the case before us we consider the duty of an insurer to act in good faith and fairly in handling the claim of an insured, namely a duty not to withhold unreasonably payments due under a policy. These are merely two different aspects of the same duty. That responsibility is not the requirement mandated by the terms of the policy itself—to defend, settle, or pay. It is the obligation, deemed to be imposed by the law, under which the insurer must act fairly and in good faith in discharging its contractual responsibilities. Where in so doing, it fails to deal fairly and in good faith with its insured by refusing, without proper cause, to compensate its insured for a loss covered by the policy, such conduct may give rise to a cause of action in tort.

66. 89 Cal. Rptr. 78 (Ct. App. 1970).
67. Id. at 93.
68. 510 P.2d 1032 (Cal. 1973) (en banc).
70. See Gruenberg, 510 P.2d at 1034-35.
for breach of an implied covenant of good faith and fair dealing.\footnote{71}

Courts have reluctantly embraced first-party bad faith as an independent tort.\footnote{72} Unlike the third-party relationship in which the insured is wholly dependent on the insurer to protect his interests, the insurer and insured do not deal in trust when a first-party claim is made. Instead, the insurer and insured “are in an adversary relationship whenever there is any claim by [the] insured for loss under any [first-party] insurance policy.”\footnote{73} Absent a special relationship, reliance on contract law affords the insured an adequate remedy. Nonetheless, a number of jurisdictions apparently recognize first-party bad faith as an independent tort.\footnote{74}

\footnote{71. Id. at 1037 (emphasis in original).


First-party bad faith translates into an insurer’s refusal to pay a claim without a lawful or reasonable basis, or an insurer’s refusal, without proper cause, to compensate an insured for a covered loss. The unreasonableness of the insurer’s conduct is the essence of the tort. The aggrieved insured generally must establish (1) the unreasonableness of the insurer’s conduct, and (2) that the insurer knew or should have known that it was being unreasonable. The reasonableness of an insurer’s conduct must be considered in light of the situation as a whole. An insurer maintains the right to deny invalid or questionable claims without being considered to be acting in bad faith.

An insurer may pass one or both prongs of the first-party bad faith test, thus avoiding extracontractual liability, by proving that its obligation to pay the claim was “fairly debatable,” or “reasonably debatable.” In other words, were there factual or legal questions concerning the insurer’s obligations that account for its delay or refusal

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78. See Forcucci v. United States Fidelity & Guar. Co., 11 F.3d 1, 2 (1st Cir. 1993).


to pay the claim.  Whether a claim is fairly or reasonably debatable generally is a question of law.

Insurers cannot be held liable for bad faith if they assert legitimate coverage defenses to a claim. Similarly, an insurer may avoid bad faith liability if its obligation to pay a claim is an open legal question, or if it changes its position and promptly resolves a claim when it learns of legal authority supporting the insured's position. It is not bad faith for an insurer to deny a claim based on a fairly debatable policy interpretation even if courts later reject that interpretation.

When faced with questions about their legal responsibilities, insurers usually seek judicial clarification or determinations of their duties through declaratory judgment actions. An insurer's legitimate resort to a judicial determination is not an act of bad faith. Most courts will not penalize an insurer for litigating an issue of first impression.

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81. See S & W Properties, Inc. v. American Motorists Ins. Co., 668 So. 2d 529, 532 (Ala. 1995) (plaintiff must show that insurer has no factual or legal defense to the claim); Morgan v. American Family Mut. Ins. Co., 534 N.W.2d 92, 96 (Iowa 1995) (claim may be fairly debatable as to either a matter of fact or law); Larsen v. Allstate Ins. Co., 857 P.2d 263, 266 (Utah Ct. App. 1993) (fairly debatable claims may concern matters of fact or law).


C. Bad Faith Damages

Modern insurance bad faith claims have their genesis in contract. First-party bad faith claims remain rooted in contract. Many aspects of the relationship between liability insurers and their insureds are contractual. For example, a liability insurer's wrongful refusal to defend its insured is a breach of contract. When an insurer is found to have breached its contract by refusing to defend a covered claim, the policyholder must be put in the position he would have enjoyed had there been no breach. Similarly, if a liability insurer declines to indemnify its insured in connection with a covered loss, or if an insurer declines to settle a claim or suit within policy limits, the insurer's failure is a breach of contract. The insured must therefore be restored to her position before the breach as a matter of fundamental contract law.

In order to incur bad faith liability, an insurer must do more than simply breach its contract with its insured. As the Arkansas Supreme Court in

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91. See Nevada Ins. Guar. Ass'n v. Sierra Auto Ctr., 844 P.2d 126, 128-29 (Nev. 1992) (requiring contractual relationship between insurer and bad faith claimant); see also Gray v. Holman, 909 P.2d 776, 780 n.9 (Okla. 1995) (while insured has but a single cause of action, the claim may be advanced concurrently on contract and tort theories).


93. See ABC Builders, 661 A.2d at 1191-92; Greer, 743 P.2d at 1250.
Court observed in *First Marine Insurance Co. v. Booth*, 96 "[t]o be liable for bad faith the insurer must engage in affirmative misconduct, without a good faith defense, in a malicious, dishonest, or oppressive attempt to avoid liability."97 While the *First Marine* court's definition of bad faith may be a bit strong,98 it makes clear that bad faith tort liability hinges on the parties' relationship independent of the insurance policy.

Insurers that breach their duty of good faith and fair dealing may face extracontractual damages. Plaintiffs may recover compensatory damages exceeding those available under contract law if they are able to link claimed losses to the insurer's conduct. Insureds may recover compensatory damages for emotional distress or mental anguish attributable to insurers' alleged bad faith,99 and they may sometimes recover interest.100 Additionally, although the standards vary, most jurisdictions allow punitive damages in bad faith actions.101

96. 876 S.W.2d 255 (Ark. 1994).
In the typical third-party case in which a liability insurer unreasonably refuses or fails to settle a case within policy limits, the key element is the insurer’s liability for the excess judgment. Assuming that the insurer acts in bad faith, the mere entry of an excess judgment is sufficient to hold the offending insurer wholly liable, even if the insured is judgment-proof. Conversely, a liability insurer’s refusal to settle cannot be deemed an act of bad faith if the subsequent verdict is within policy limits. There must be an excess judgment in order for an insured to be damaged by a liability insurer’s refusal to settle.

III. COMPARATIVE FAULT AND COMPARATIVE BAD FAITH

The ease with which insureds can assert bad faith claims adversely affects insurers’ ability to fully investigate and ultimately deny fraudulent and frivolous claims. Insureds’ suits against insurers have proliferated since the early 1980s. Insurers spend significant sums defending suits in which their insureds’ misconduct or negligence contributed to the claimed damages. Consequently, all insured consumers bear the costs associated with bad faith litigation through increased premiums. Ultimately, consumers’ ability to procure insurance in some states may be affected.
A. Courts' Acceptance of Comparative Bad Faith and Comparative Fault

"Comparative bad faith" is just that: a comparison of the insured's deliberate or intentional misconduct with that of the insurer. The defense of comparative bad faith rests on the premise that if insureds are not allowed to recover when their conduct has been wrongful, they are more likely to assist insurers in the timely and reasonable resolution of their claims.

"Comparative fault" refers to the comparison of insureds' negligence with insurers' alleged reckless or willful misconduct. In the bad faith context, the application of comparative fault principles seems incongruous. Specifically, the defense requires courts and juries to compare insureds' simple negligence with insurers' reckless or willful misconduct. As a practical matter, courts generally fail to distinguish between these two affirmative defenses, or they use them interchangeably.

Whether courts will allow insurers to assert their insureds' comparative bad faith or comparative fault in particular cases is always an open question. In Carpenter v. Automobile Club Interinsurance Exchange, the Eighth Circuit apparently recognized comparative fault as an affirmative defense to a third-party bad faith claim. However, because there was no evidentiary support for the defense on the record before it, the Carpenter court upheld the trial court's decision to preclude the insurer's use of the defense below.

In First National Bank of Louisville v. Lustig, a federal district court in Louisiana applying Kentucky law refused to strike an insurer's comparative bad faith defense. The court reasoned that because the plaintiff could not show that the defense had been unequivocally rejected by Kentucky courts, its application presented a substantial legal question.

108. Richmond, supra note 23, at 50.
110. Richmond, supra note 23, at 50.
111. Id.
112. 58 F.3d 1296 (8th Cir. 1995).
113. Id. at 1303.
114. Id. at 1303-04 (citing Worden v. Tri-State Ins. Co., 347 F.2d 336 (10th Cir. 1965)).
116. Id. at *1.
117. Id. at *2.
Several courts have refused to instruct juries on comparative bad faith or comparative fault without expressly rejecting the doctrines. In *Alexander Underwriters General Agency, Inc. v. Lovett*,118 the trial court refused to instruct the jury on the insured’s bad faith. The Georgia Court of Appeals affirmed the trial court, but based its decision on the absence of evidence supporting the offered instruction.119 Similarly, in *Jessen v. National Excess Insurance Co.*,120 the New Mexico Supreme Court affirmed the trial court’s refusal to submit a comparative bad faith instruction, cautiously stating that it was not deciding “whether such an instruction necessarily would be inappropriate in another case.”121

A number of courts have expressly rejected the two defenses. In *Nationwide Property & Casualty Insurance Co. v. King*,122 a Florida appellate court held that the trial court did not err in striking the insurer’s comparative bad faith defense. The *King* court unequivocally held: “We decline to create a new affirmative defense of comparative bad faith.”123 Similarly, in *Stumpf v. Continental Casualty Co.*,124 Oregon rejected comparative fault in bad faith cases. The *Stumpf* court observed that “it would be nonsensical to hold that an insured who has bargained away control of his own case nevertheless may be liable for conducting it negligently.”125 The court reasoned that the defense was unavailable to insurers because the rights and duties of parties to insurance policies are contractual in nature.126

The Montana Supreme Court also rejected comparative fault in bad faith cases in *Stephens v. Safeco Insurance Co. of America*.127 The *Stephens* plaintiffs sued Safeco when they were unable to settle their first-party fire claim. At trial, Safeco compared the plaintiffs’ fault, alleging that they violated their duty of good faith and fair dealing, failed to mitigate their damages, and interfered with Safeco’s

119. *Id.* at 265.
120. 776 P.2d 1244 (N.M. 1989).
121. *Id.* at 1249.
123. *Id.* at 990-91.
125. *Id.* at 1233.
performance of its contractual duties. The jury found the plaintiffs to be fifty-three percent at fault and Safeco forty-seven percent at fault; under Montana's modified comparative fault scheme, the plaintiffs recovered nothing. On appeal, the plaintiffs argued that comparative fault did not apply to bad faith cases. The Stephens court agreed.

The Stephens court first observed that only tortious conduct can be compared. If the insurer breaches the duty of good faith and fair dealing, the insured's cause of action sounds in tort. But, the court noted, if the situation is reversed, the insured's bad faith conduct is merely a breach of contract.

The court determined that bad faith is a tort only when the parties have a special relationship. While an insured shares a special relationship with his insurer, the converse is not true. The insurer's superior economic position frees it from the fear of oppression and the risk of financial harm burdening an insured. Comparing the parties' respective causes of action and remedies to "apples and oranges," the Stephens court reinstated the plaintiffs' entire verdict.

Not all courts, however, have rejected comparative bad faith and comparative fault. At least a few courts have sensed that in bad faith cases, "the fact finder, in its search for truth, should be able to look at the whole forest and not just a few of the trees. This should include a view of the insured's conduct as well . . ." For instance, despite the Stephens decision, Montana has effectively recognized comparative fault when it was not so described. In Juedeman v. National Farmers Union Property & Casualty Co., the insured, the mother of a minor child, refused to release the estate of the deceased driver in whose vehicle her son was injured. The decedent's insurer offered the plaintiff its $100,000 policy limits if she would release the insured's estate from any future loss of consortium claim, in addition to her son's claim. When she refused to execute a

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128. Id. at 567.
129. Id.
130. Id. at 568; accord California Fair Plan Ass'n v. Politi, 270 Cal. Rptr. 243, 246 (Ct. App. 1990).
132. Id.
133. Id. at 569.
136. Id. at 192.
complete release, the insurer refused to settle the claim by paying its policy limits. 137

The plaintiff then sued the insurer for violating the Montana Unfair Claim Practices Act by refusing to promptly and fairly settle a claim for which its insured was clearly liable. 138 The trial court granted the insurer’s summary judgment motion and the Supreme Court of Montana affirmed. The Juedeman court reasoned that the plaintiff’s conduct prevented the insurer from promptly and fairly resolving her claim. 139 The court further noted that precedent compelled it to reject an insurance bad faith claim “where the plaintiff’s conduct caused the delay in payment.” 140

A California court explicitly recognized comparative fault as an affirmative defense to an insurer’s alleged bad faith in Patrick v. Maryland Casualty Co. 141 In Patrick, the plaintiff purchased homeowner’s insurance from Maryland Casualty. In December, 1982, windstorms blew shingles from a portion of the plaintiff’s roof. The plaintiff temporarily repaired the roof to prevent further damage and submitted a claim. Thereafter, the parties’ versions of events differed. Maryland Casualty claimed that the plaintiff was in no hurry to resolve the claim, that he communicated no sense of urgency about its payment, and that he mailed in the claim rather than hand-delivering it or calling. Maryland Casualty asserted that it acted reasonably on the claim once it was received. 142 The plaintiff alleged that he told the adjuster that water was pouring through holes in the roof and that he needed money to make necessary repairs. The scenario then went from bad to worse, according to the plaintiff:

[Maryland Casualty], however, forced him to get needless documentation and estimates which caused seemingly endless delays; then told him the check was in the mail; then told him the check must have been lost; and then delayed further in issuing another one. As a result of this delay, three months later in early March of 1983 after further water damage to his house, [plaintiff] called . . . again to complain that he still needed the money, and that water damage to his house was continuing . . . [Plaintiff], who was a carpenter . . . then got up on the roof again to do the necessary repairs himself. He claimed that

137. Id. at 193.
138. Id. at 192-93.
139. Id. at 193.
140. Id. (citing Spadaro v. Midland Claims, Inc., 740 P.2d 1105, 1110 (Mont. 1987)).
142. Id. at 26.
[Maryland Casualty’s] employee had told him to do this work himself, although he also later admitted that doing the work himself might have been his own idea after all.

In any event, once he got up on the roof again, [plaintiff] decided . . . he would need to replace the entire roof . . . . He went out to buy the necessary supplies, then later returned. While he was walking backward on the roof . . . he lost his balance and had to jump eight feet down onto the sidewalk. Both of his heels were severely injured . . . . He presented evidence showing that as a result he has been disabled from his job as a carpenter ever since.\textsuperscript{143}

One of the causes submitted to the jury was Maryland Casualty’s breach of the implied covenant of good faith and fair dealing.\textsuperscript{144} The trial court refused the insurer’s request that the jury be instructed to assess the fault of the parties by comparing its bad faith with the plaintiff’s negligence.\textsuperscript{145} The jury returned a plaintiff’s verdict, awarding both compensatory and punitive damages, and Maryland Casualty appealed.

The appellate court reversed.\textsuperscript{146} The court first noted that while comparative fault had not previously been considered by an appellate court, the absence of precedent was not a good reason to reject it.\textsuperscript{147} Indeed, it noted, most defenses now recognized in tort cases were once novel.\textsuperscript{148} Second, the court saw no reason to reject the defense when it was recognized in products liability actions, in which a plaintiff’s negligence is compared against a manufacturer’s strict liability.\textsuperscript{149} “While the duty of good faith and fair dealing arises out of a contractual relationship, [its] breach . . . and the ensuing damages are governed by tort principles.”\textsuperscript{150} Third, California courts already allowed the comparison of fault attributable to negligence and willful misconduct in personal injury actions.\textsuperscript{151} Thus, as previously noted in the products liability context, the court found that such a comparison appeared legally sound.

\textsuperscript{143} Id.

\textsuperscript{144} See id.

\textsuperscript{145} Id. at 27.

\textsuperscript{146} Id.

\textsuperscript{147} Id. at 28.

\textsuperscript{148} Id. (quoting California Cas. Gen. Ins. Co. v. Superior Ct., 218 Cal. Rptr. 817, 821 (Ct. App. 1985)).

\textsuperscript{149} Id.

\textsuperscript{150} Id.

\textsuperscript{151} Id. The application of comparative fault principles to negligent conduct on one hand and willful misconduct on the other was announced in Sorensen v. Allred, 169 Cal. Rptr. 441 (Ct. App. 1980).
Finally, the court reasoned that comparative fault "may not always be avoided by plaintiff’s unilateral manipulation of the mere denomination of his claim where the defendant contends that, if there was any liability at all, it arose as a result of negligence; and where that theory is supported by the evidence." 152 The Patrick court thus concluded that comparative negligence may be available as an affirmative defense in an action for an insurer’s bad faith. 153

In California State Automobile Ass’n. Inter-Insurance Bureau v. Bales, 154 a plaintiff’s attorney’s actions were at issue. Bales, the attorney, was hired in 1983 by an elderly plaintiff, Dorothy Cooper, to prosecute her personal injury claim against California State Automobile Inter-Insurance Bureau’s (CSAA) insured. Bales did not energetically pursue the claim, he refused to negotiate a settlement with CSAA, and he failed to seek an early trial date, to which Cooper’s age entitled her. 155 That action against CSAA’s insured was finally settled in May, 1987. In December, 1987, represented by new counsel, Cooper sued CSAA for bad faith, alleging that it failed to settle her personal injury action promptly despite its insured’s clear liability. 156

CSAA pleaded Bales’ negligence in handling Cooper’s personal injury claim as an affirmative defense. 157 CSAA also cross-claimed against Bales for implied equitable indemnity, alleging that Bales was largely responsible for the delays that led to Cooper’s claimed damages. Therefore, CSAA argued, Bales should pay his comparative share of those damages. 158

The trial court dismissed CSAA’s cross-claim and the court of appeals affirmed. The Bales appellate court reasoned that, in such circumstances, allowing insurers’ pursuit of implied equitable indemnity claims would create conflicts of interests for plaintiffs’ personal injury counsel:

Where the attorney represents either a first or third party claimant on an insurance policy, the interest of the client is necessarily adverse to that of the insurer, even though there may not be any underlying action against the insurer. In such situations, there is a possibility that conduct of the insurer may subject it to liability for bad faith. That possibility in turn creates a potential conflict between the attorney’s duty to pursue

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153. Id. at 30.
155. Id. at 422.
156. Id. at 422-23.
157. See id. at 424.
158. Id. at 423.
the client’s claim vigorously, and the understandable desire to avoid conduct which might later be the basis for the attorney’s personal liability in indemnity to the insurer. An attorney who believed that the insurer had engaged or was about to engage in bad faith claims practices might well choose to avoid such liability by acting to shield the insurer, even though his or her client would be ill-served by such action.\footnote{159}

The appellate court did, however, recognize the validity of CSAA’s affirmative defense.\footnote{160} Bales thus expanded the comparative fault doctrine to allow a comparison of plaintiffs’ or insureds’ counsel’s conduct.

The concept of comparative bad faith surfaced in \textit{Fleming v. Safeco Insurance Co. of America, Inc.}\footnote{161} The Fleming plaintiff was severely injured when the car in which she was a passenger was struck by a stolen vehicle. At the time of the accident she maintained uninsured motorist coverage with Safeco, with policy limits of $15,000. Safeco offered $10,000 to settle her claim, which she rejected. The matter was ultimately resolved by a $15,000 arbitration award more than one year after the accident.\footnote{162}

After payment of the arbitration award, the plaintiff sued Safeco for compensatory and punitive damages on the ground that Safeco had been guilty of bad faith, as well as malicious and oppressive conduct in the handling of her claim.\footnote{163} A jury returned a verdict in the plaintiff’s favor, awarding her gross compensatory damages totaling $14,300. The jury determined that twenty-six percent of plaintiff’s compensatory damages were attributable to her bad faith conduct and seventy-four percent were attributable to Safeco’s bad faith conduct. The jury also awarded the plaintiff $116,500 in punitive damages.\footnote{164}

The court observed that the comparison of the parties’ bad faith was unprecedented, but because neither party objected to the related special verdict form, and because neither party chose to address the issue on appeal, its propriety need not be discussed.\footnote{165} Safeco did contend on appeal that the punitive award should be reduced by its insured’s bad faith, as were the compensatory damages. The Fleming court rejected the argument, noting that “bad faith on the one hand, and malice,
oppression, or fraud on the other hand are not equivalents, and any attempt to compare them would amount to a comparison of apples and oranges."¹⁶⁶

An Arizona court reached a different conclusion in Borland v. Safeco Insurance Co. of America.¹⁶⁷ In deciding whether to allow an award of punitive damages against the defendant insurer, the Borland court "also [thought] it proper to consider the insured's conduct."¹⁶⁸ The Borland plaintiff had almost immediately consulted with a knowledgeable insurance attorney upon delay in the payment of her claim. There was understandable confusion concerning coverage, and the plaintiff and her attorney were of no help in resolving questions. In fact, the plaintiff's attorney, although well-versed in insurance matters, "stood by and permitted the [insurer] to fumble its way into difficulty without seriously trying to straighten things out."¹⁶⁹ As a result, the court struck the plaintiff's punitive damages award.

In California Casualty General Insurance Co. v. Superior Court,¹⁷⁰ a California court finally adopted the defense of comparative bad faith. The plaintiff insured in California Casualty allegedly suffered a loss compensable under the uninsured motorist coverage provided in her automobile insurance policy. After California Casualty declined to pay the plaintiff's claim, she pursued the matter through arbitration and received a favorable award. She then sued California Casualty for its alleged breach of the duty of good faith and fair dealing, fraud, intentional infliction of emotional distress, and certain statutory violations.¹⁷¹ The insurer sought leave to amend its answer to include an affirmative defense of comparative bad faith by the plaintiff and her former attorney in the handling and management of her claim.¹⁷² The trial court denied the insurer's motion and the issue reached the court of appeal by writ of mandamus.

The plaintiff contended that there existed no authority recognizing affirmative comparative bad faith as an affirmative defense to an action

¹⁶⁶. Id.
¹⁶⁸. Id. at 558. In Borland, the plaintiff's house was burglarized the day after her policy with Safeco expired. Id. at 553. Even though the plaintiff had insured herself through a new insurer, she also extended her coverage with Safeco through a grace period of renewal. Id. Delays and confusion resulted when Safeco personnel did not know that the policy had been renewed or to what extent the loss was covered by the second insurer. Id. at 555.
¹⁶⁹. Id.
¹⁷⁰. 218 Cal. Rptr. 817 (Ct. App. 1985).
¹⁷¹. Id. at 818.
¹⁷². Id. at 819.
for an insurer's bad faith. Thus, the comparative bad faith defense was not legally cognizable or, at the very most, constituted a "disfavored" defense.\footnote{Id. at 820.} The court easily rejected the plaintiff's argument:

Plaintiff's assertion that the defense of "comparative bad faith" would constitute a "disfavored" defense is not persuasive and, indeed, is a bit puzzling. If, as plaintiff appears to suggest, the fact that "comparative bad faith" has not been heretofore recognized in a published appellate opinion as a partial or complete defense to a bad faith action renders it a "disfavored" defense, we reject that suggestion. Presumably, most defenses now recognized in tort cases were at one time novel and not expressly recognized in published judicial decisions. "Disfavored" defenses are such because of public policy considerations, not because they are novel.\footnote{Id. at 821.}

The \textit{California Casualty} court was persuaded that, "in an appropriate case, an insured's breach of the implied duty of good faith and fair dealing which contributes to an insurer's" timely resolution of the subject claim may constitute at least a partial affirmative defense to the insurer's alleged breach.\footnote{Id. at 822.} In so holding, the court noted that the duty of good faith and fair dealing is a two-way street.\footnote{Id. \cite*{Id. at 822-23.} Moreover, \"[t]he specific content of each party's duty is 'dependent upon the nature of the bargain struck between the insurer and the insured and the legitimate expectations of the parties which arise from the contract.\"\footnote{Id. at 823.}

There could be little question, the court observed, that an insurer providing uninsured motorist coverage has a reasonable expectation that the insured suffering a loss will promptly and accurately furnish all known evidence and information pertinent to the claim.\footnote{Id. (quoting Commercial Union Assur. Cos. v. Safeway Stores, Inc., 610 P.2d 1038, 1041 (Cal. 1980)).} If an insured's failure to do so delays or impedes the insurer's investigation or payment of the claim, the court reasoned, there existed no sound reason that the doctrine of comparative fault should not be applied to bad faith cases.\footnote{Id. at 822.} Accordingly, the appellate court permitted the insurer to amend its answer and clearly allege the affirmative defense of the insured's comparative bad faith.\footnote{Some commentators suggest that \textit{California Casualty} actually limits the scope of the duty of good faith and fair dealing to cases involving the insurer's investigation or payment of the claim. \cite{Id. at 823.}}
B. The Insured's Failure to Cooperate

Insureds' comparative bad faith or comparative fault is necessarily related to insureds' express contractual duties to cooperate with their insurers. Cooperation clauses in liability insurance policies obligate insureds to assist insurers in the conduct and defense of third-party actions.  

In any given case an insured must attend depositions, hearings, and trials; assist in discovery; participate in or support settlement negotiations; and enforce the insurer's subrogation rights. First-party insurance policies impose specific obligations on the insured that effectively require the insured's cooperation. These policies routinely require insureds to allow the insurer's inspection of property, submit to examinations under oath, and produce otherwise confidential documents or records. An insured may also be required of comparative bad faith to the insured's personal acts or to those acts committed with the insured's actual authority. Anderson, supra note 19, at 508 & n.172. That is probably an overstatement, however. The California Casualty court simply observed that an insured might bear liability for the authorized acts of her agents and, similarly, that the conduct of the insured's attorneys or others that cannot be imputed to the insured will not defeat or diminish the insured's recovery. California Casualty, 218 Cal. Rptr. at 822. This is nothing more than traditional agency analysis. Applying traditional agency law principles, the bad faith conduct of the insured's attorney generally should be imputed to the insured. Anderson, supra note 19, at 509-10. The insurer need only establish that the attorney had apparent authority to act on the insured's behalf. Id. at 510. Presumably, there are other persons who, if acting in bad faith on the insured's behalf, will see their actions imputed to the insured. Such agents of the insured might include, without limitation, public adjusters, insurance brokers, contractors and accountants.


182. See Forest City Grant Liberty Assocs. v. Genro II, Inc., 652 A.2d 948, 951-52 (Pa. Super. Ct. 1995) (insured must provide insurer with information necessary to prepare defense, aid in securing witnesses' appearance, attend hearings and trials, and otherwise "render all reasonable assistance necessary"); In re Environmental Insurance, 612 A.2d at 1342 ("[I]nsureds are generally required to provide all such information and assistance as the insurer may require.")

to submit to a physical examination by a doctor of the insurer's choice.\textsuperscript{184}

An insurer may require its insured to abide by the terms of its policy, including a cooperation clause.\textsuperscript{185} The insured's and the insurer's obligations under the cooperation clause are reciprocal.\textsuperscript{186} The insured must cooperate with the insurer and the insurer must exercise reasonable diligence in obtaining the insured's cooperation.\textsuperscript{187}

An insured's substantial and material breach of its duty to cooperate terminates the insurer's obligations only when the insured's conduct prejudices the insurer.\textsuperscript{188} An insurer may use an insured's failure to cooperate to defend against a bad faith claim where the insurer has concluded its investigation or withdrawn its defense.\textsuperscript{189} Whether an insurer has been prejudiced is ordinarily a question of fact.\textsuperscript{190} The


\textsuperscript{189} See Cherry v. Anthony, 501 So. 2d 416, 420 (Miss. 1987) ("[I]t is difficult to see how the insurance adjuster can be faulted for bad faith when it is clear that the [insureds] did not cooperate with him in his investigation.").
insurer bears the burden of proving the insured’s breach of the cooperation clause.\textsuperscript{191}

Factual differences in individual cases make it impossible to formulate a bright-line rule regarding particular acts as evidence of failure to cooperate. Prejudice results where the insured’s conduct prevents the insurer from adequately investigating or defending a claim.\textsuperscript{192} The insurer may carry its burden if it can show that the insured’s cooperation would have allowed it to negate liability. Similarly, the subsequent discovery of key evidence previously unknown because of the insured’s failure to cooperate might establish that the outcome would have been different had the insured cooperated.\textsuperscript{193} In first-party cases, an insured’s refusal to produce records or to submit to an examination under oath generally invalidates coverage.\textsuperscript{194}

Among the more unusual non-cooperation cases is \textit{National Chiropractic Mutual Insurance Co. v. Cannon.}\textsuperscript{195} \textit{Cannon} illustrates the sort of conduct that might support a comparative bad faith defense. In \textit{Cannon}, chiropractor Donald Cannon (Cannon) was sued for malpractice in a California state court. Cannon tendered his defense to National Chiropractic Mutual Insurance Co. (NCMIC). Ultimately, the malpractice plaintiffs prevailed; however, Cannon’s conduct significantly contributed to their success. Cannon refused to consent to settlement, fired NCMIC’s chosen defense counsel shortly before trial, failed to obtain substitute counsel, attempted to remove the case to federal court, and failed to appear at trial.\textsuperscript{196}

NCMIC filed an interpleader action in federal court seeking a declaratory judgment absolving it of liability in excess of its policy limits.\textsuperscript{197} Cannon counterclaimed for NCMIC’s breach of its duty of good faith and fair dealing.\textsuperscript{198} The district court held that NCMIC breached its duty of good faith to Cannon in connection with the

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  \item \textsuperscript{192} See Reid v. Connecticut Gen. Life Ins. Co., 17 F.3d 1092, 1098 (8th Cir. 1994) (interpreting Missouri law).
  \item \textsuperscript{193} ROBERT H. JERRY II, UNDERSTANDING INSURANCE LAW 425 (1987).
  \item \textsuperscript{194} See, e.g., Brown v. Danish Mut. Ins. Ass’n, 550 N.W.2d 171, 175 (Iowa Ct. App. 1996).
  \item \textsuperscript{195} Nos. 89-15903, 89-16013, 1991 WL 39887 (9th Cir. Mar. 20, 1991).
  \item \textsuperscript{196} Id. at *2.
  \item \textsuperscript{197} Id. at *1.
  \item \textsuperscript{198} Id.
underlying malpractice action by failing to inform him of a conflict of interest and his right to engage independent counsel of his choice.\textsuperscript{199} The court further held, however, that Cannon’s bizarre conduct constituted a breach of his duty to cooperate in NCMIC’s defense.\textsuperscript{200} In fact, the court determined that Cannon’s conduct was unreasonable as a matter of law and proximately caused the malpractice award.\textsuperscript{201} The district court entered summary judgment for NCMIC, and the Ninth Circuit Court of Appeals affirmed.\textsuperscript{202}

\textbf{IV. REVERSE BAD FAITH}

If an insurer may assert its insured’s bad faith as an affirmative defense, may it similarly sue its insured for a breach of the duty of good faith and fair dealing? In other words, does an insured’s breach of the duty of good faith and fair dealing provide a basis for the insurer’s affirmative relief? If the duty of good faith and fair dealing truly is a “two-way street,” should mutual duties come with mutual remedies? Assuming the answer to this last question is “yes,” an insurer suing its insured in tort for alleged bad faith may be said to be pursuing a “reverse bad faith” claim.\textsuperscript{203}

In one of the few reverse bad faith cases reported, \textit{First Lehigh Bank v. North River Insurance Co.},\textsuperscript{204} a federal district court in Pennsylvania rejected the cause of action. In \textit{First Lehigh}, the plaintiff bank sued North River to recover under a banker’s blanket bond for a loss attributable to employee fraud. North River counterclaimed under three theories, including the bank’s alleged breach of its duty of good faith and fair dealing.\textsuperscript{205} The First Lehigh Bank filed a claim with North River, alleging that it suffered a loss of approximately $400,000 due to an employee’s dishonest acts. The bank claimed that the employee concealed and entered into unauthorized loan transactions. North River began its investigation and requested copies of minutes from directors’ meetings, loan reports, and FDIC examination reports.\textsuperscript{206} The bank informed North River that the information sought was confidential and that it would have to enter into a related confidentiality agreement. The

\begin{itemize}
  \item 199. \textit{Id.} at *2.
  \item 200. \textit{Id.}
  \item 201. \textit{Id.}
  \item 202. \textit{Id.} at *1.
  \item 203. Richmond, \textit{supra} note 23, at 64.
  \item 205. \textit{Id.} at *1.
  \item 206. \textit{Id.}
\end{itemize}
parties attempted to negotiate a resolution, but, before reaching agreement, the bank sued North River to collect its claim.\textsuperscript{207} After a consent protective order was entered, discovery got underway. The bank provided North River with records apparently unrelated to the unauthorized loans at issue. North River later discovered that the records were altered before their production.\textsuperscript{208} The insurer alleged that all references to the loans purportedly unauthorized or concealed were deleted, that loan reports reflecting a fraudulent letter of credit transaction were prepared, and that minutes of meetings were altered to reflect the dishonest employee’s termination.\textsuperscript{209}

North River’s counterclaim for the bank’s alleged breach of its duty of good faith and fair dealing posed a novel issue for the \textit{First Lehigh} court.\textsuperscript{210} The court recognized that “’the utmost fair dealing should characterize the transaction between an insurance company and the insured.’”\textsuperscript{211} The court nonetheless dismissed North River’s counterclaim. While the bank’s breach of its duty of good faith might permit North River to avoid liability under its bond, it would not support a separate claim by North River for money damages.\textsuperscript{212} The \textit{First Lehigh} court offered no reasoning for its conclusion. The court noted, however, that North River remained free to sue the bank for malicious use of process should it prevail in the pending suit.\textsuperscript{213}

Ohio rejected the reverse bad faith doctrine in \textit{Tokles & Son, Inc. v. Midwestern Indemnity Co.}\textsuperscript{214} The \textit{Midwestern Indemnity} plaintiff sued its insurer for breach of contract and bad faith when it denied the plaintiff’s claim for the theft of a truck.\textsuperscript{215} Midwestern counterclaimed for fraud and the insured’s reverse bad faith.\textsuperscript{216} The case proceeded to a bifurcated trial, with the insured’s breach of contract claim being tried first. The insurer obtained a directed verdict and after the trial obtained summary judgment on the insured’s bad faith claim. The trial court then dismissed \textit{sua sponte} Midwestern’s reverse bad faith counterclaim.\textsuperscript{217}

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\item \textsuperscript{207} \textit{Id.}
\item \textsuperscript{208} \textit{Id.}
\item \textsuperscript{209} \textit{Id.}
\item \textsuperscript{210} \textit{Id.} at *2.
\item \textsuperscript{211} \textit{Id.} at *4 (quoting Dercoli v. Pennsylvania Nat’l Mut. Ins. Co., 554 A.2d 906, 909 (Pa. 1989)).
\item \textsuperscript{212} \textit{Id.}
\item \textsuperscript{213} \textit{Id.}
\item \textsuperscript{214} 605 N.E.2d 936 (Ohio 1992).
\item \textsuperscript{215} \textit{Id.} at 939.
\item \textsuperscript{216} \textit{Id.}
\item \textsuperscript{217} \textit{Id.}
\end{itemize}
The Ohio Court of Appeals reversed the directed verdict and the insurer’s summary judgment on the bad faith claim, and it affirmed the dismissal of Midwestern’s counterclaim.\textsuperscript{218} The Ohio Supreme Court affirmed the intermediate appellate court in part and reversed it in part.\textsuperscript{219} The supreme court refused to recognize the tort of reverse bad faith,\textsuperscript{220} reasoning that the insurer, who invariably has a superior bargaining position, is not in need of a reverse bad faith cause of action.\textsuperscript{221} The \textit{Midwestern Indemnity} court offered no other bases for its rejection of the insurer’s reverse bad faith proposition.

Iowa recently rejected a reverse bad faith cause of action in \textit{Johnson v. Farm Bureau Mutual Insurance Co}.\textsuperscript{222} In \textit{Johnson}, plaintiffs Verdell and Marian Johnson sued Iowa Lakes Electric Cooperative when Marian was seriously injured by a downed power line on their property. Iowa Lakes crossclaimed against Verdell, alleging his comparative fault. Mr. Johnson tendered the crossclaim to his liability insurer, Farm Bureau. Farm Bureau denied coverage because the claim fell squarely within an exclusion in its policy.\textsuperscript{223} Specifically, the Farm Bureau policy excluded from coverage bodily injury to insureds, including spouses and relatives.\textsuperscript{224}

The jury in the underlying personal injury action returned a verdict of approximately $690,000 in favor of the Johnsons. The jury apportioned eighty percent of the fault to Iowa Lakes and twenty percent to Mr. Johnson. Iowa Lakes paid the judgment in full and was


\textsuperscript{219} \textit{Id.} at 945.

\textsuperscript{220} \textit{Id.} at 945.

\textsuperscript{221} \textit{Id.} Specifically, the court stated:

As the holder of the purse strings, the insurer has a certain built-in protection from such evils. On the other hand, the insured, who often finds himself in dire financial straits after the loss, must have the equal footing which is provided by the ability to sue the insurer for bad faith. There are other avenues for the insurer to pursue in the event that an insured submits a fraudulent claim.

An insurer drafts the policy, can refuse the insured’s claim, and could assert a cause of action against the insured for fraud.

\textit{Id.}

\textsuperscript{222} 533 N.W.2d 203 (Iowa 1995).

\textsuperscript{223} \textit{Id.} at 205.

\textsuperscript{224} \textit{Id.} at 206-07.
then awarded judgment for contribution against Verdell for his percentage of fault.\textsuperscript{225}

Mr. Johnson then sued Farm Bureau for breach of contract, alleging that it should have defended and indemnified him against Iowa Lakes’ crossclaim. He also alleged that Farm Bureau’s refusal to defend and indemnify him amounted to bad faith.\textsuperscript{226} Farm Bureau counterclaimed, alleging that Mr. Johnson’s bad faith allegations constituted reverse bad faith and an abuse of process.\textsuperscript{227}

The trial court granted Farm Bureau’s summary judgment motion on Mr. Johnson’s breach of contract and bad faith claims.\textsuperscript{228} The insurer’s counterclaims went to trial. The trial court directed a verdict against Farm Bureau on its reverse bad faith and abuse of process claims without ruling on the viability of the insurer’s reverse bad faith cause of action. In short, the trial court held that Mr. Johnson’s conduct did not rise to the level of bad faith.\textsuperscript{229}

Farm Bureau appealed both the reverse bad faith and abuse of process directed verdicts.\textsuperscript{230} On appeal, Farm Bureau argued that the Supreme Court of Iowa should recognize a cause of action for reverse bad faith favoring insurers when insureds pursue frivolous bad faith claims.\textsuperscript{231} Farm Bureau did not dispute insureds’ right to pursue breach of contract claims to enforce insurers’ coverage obligations. Rather, Farm Bureau objected “to the ‘linking of a frivolous tort claim to [Johnson’s] contract claim in an attempt to gain unfair advantage’” in what should be a simple breach of contract action.\textsuperscript{232} The insurer pointed out that its coverage position was “fairly debatable,” and hence reasonable as demonstrated by its victory at the summary judgment stage. Farm Bureau also argued that Mr. Johnson failed to study his policy closely before alleging the company’s bad faith, as evidenced by the fact that he could not point to a single policy provision supporting his argument that Farm Bureau acted unreasonably. Farm Bureau thus contended that Johnson’s allegations of bad faith were themselves made in bad faith.\textsuperscript{233}

\textsuperscript{225} Id. at 205.
\textsuperscript{226} Id.
\textsuperscript{227} Id.
\textsuperscript{228} Id.
\textsuperscript{229} Id.
\textsuperscript{230} Id.
\textsuperscript{231} Id. at 207.
\textsuperscript{232} Id.
\textsuperscript{233} Id.
Appreciating that the Johnson court might find no common law support for its position, Farm Bureau argued that the mutual obligation of good faith, coupled with insurers’ right to deny fairly debatable first-party claims, favored adopting the tort of reverse bad faith. The insurer further argued that judicial recognition of first-party bad faith as an independent tort has given insureds an unfair litigation advantage, creating the need for a counterbalancing reverse bad faith cause of action. In response, the plaintiff argued that recognizing a reverse bad faith cause of action was unnecessary. The plaintiff asserted that court imposed sanctions and the abuse of process cause of action afford insurers adequate remedies for frivolous first-party bad faith claims.

The Johnson court declined to adopt the tort of reverse bad faith. The court reasoned that sanctions available under the Iowa Rules of Civil Procedure provide an adequate remedy for insurers when insureds pursue frivolous bad faith claims. When Farm Bureau protested that sanctions are inadequate because courts so rarely impose them, the Johnson court responded that a single published decision in a medical malpractice case demonstrated that “courts are willing to impose sanctions when confronted with an appropriate case.” Finally, the Supreme Court went on to affirm the trial court’s directed

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234. This was a valid concern and was reflected in the Johnson court’s comment that it was “aware of no jurisdiction that has adopted the tort of reverse bad faith.” Id. at 208.

235. Id. at 207.

236. Id. at 207-08.

237. Id. at 208.

238. Id.

239. Under Iowa Rule of Civil Procedure 80(a), an attorney’s signature on a pleading or other court document constitutes the attorney’s certification that he:

- has read the motion, pleading, or other paper; that to the best of Counsel’s knowledge, information and belief, formed after reasonable inquiry, it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; and that it is not interposed for any improper purpose, such as to harass or cause an unnecessary delay or needless increase in the cost of litigation.

Id. (quoting IOWA R. CIV. P. 80(a)). The Rule further provides for “an appropriate sanction, which may include an order to pay the other party . . . the amount of the reasonable expenses incurred because of the filing of the motion, pleading, or other paper, including a reasonable attorney fee.” Id. (quoting IOWA R. CIV. P. 80(a)).

240. Johnson, 533 N.W.2d at 208.

241. The case cited by the Johnson court is Fields v. Iowa District Court, 468 N.W.2d 38 (Iowa 1991).

242. Johnson, 533 N.W.2d at 208.
verdict in Mr. Johnson's favor on Farm Bureau's abuse of process claim.\textsuperscript{243}

Although courts have been reluctant to embrace reverse bad faith, that does not mean that the doctrine is dead on arrival. In \textit{Snap-On Tools Corp. v. First State Insurance Co.},\textsuperscript{244} a Wisconsin jury returned a reverse bad faith verdict for the insurer. In \textit{Snap-On Tools}, the insured corporation and First State negotiated a "manuscript" policy.\textsuperscript{245} The policy included a unique cooperation clause and a standard definition of "occurrence."\textsuperscript{246}

In 1985, George Owens, a Snap-On dealer in California, sued Snap-On for wrongfully terminating his dealership contract. Owens alleged a variety of causes of action and pleaded his entitlement to both compensatory and punitive damages. Under the terms of the policy, Snap-On investigated and defended Owens' suit. Snap-On's in-house counsel estimated the company's potential exposure at less than $100,000, meaning that any potential loss would fall within Snap-On's self-insured retention (SIR).\textsuperscript{247} Accordingly, Snap-On did not notify First State of Owens' suit. Even after Owens presented his case at trial and Snap-On's California trial counsel informed the company

\textsuperscript{243} Id. at 209.
\textsuperscript{244} No. 91-1356, 1993 WL 91563 (Wis. Ct. App. Mar. 31, 1993).
\textsuperscript{245} Id. at *1. A manuscript policy is an insurance policy written to include specific coverages or conditions not included in standard policies.
\textsuperscript{246} See id. at *2. The cooperation clause read:

\textbf{ASSISTANCE AND COOPERATION OF THE INSURED:}

The Company shall not be called upon to assume charge of the defense or settlement of any claims made or suits brought or proceedings instituted against the Insured. The Insured shall be responsible for the investigation and defense of any claim made or suit brought or proceeding instituted against the Insured to which this Contract applies. The Insured shall use diligence, prudence and good faith in the investigation defense and settlement of all such claims and shall not unreasonably refuse to settle any which, in the exercise of sound judgment should be settled, provided, however, that the Insured shall not make or agree to any settlement for any sum which would involve the limits of the Company's liability hereunder without the approval of the Company.

The Company shall have the right and shall be given the opportunity to associate with the Insured in the defense and control of any claim, suit or proceeding which involves or appears reasonably likely to involve the Company and in which event the Insured and the Company shall cooperate in all things in defense of such claim, suit or proceeding.

The Company, if it so elects and at its sole option, shall have the right to assume complete control of any claim which appears likely to involve the Company's limit of liability under this Contract.

\textsuperscript{247} Id. at *3.
that its liability exposure might exceed $100,000, Snap-On still did not notify First State.\(^{248}\)

The jury in Owens’ case returned a verdict for the plaintiff and assessed considerable damages against Snap-On. They awarded Owens compensatory damages of $282,554 and punitive damages of $6,567,000. The California trial court later reduced the punitive damage award to $4,000,000.\(^{249}\)

Snap-On notified First State of the claim and the verdict within a week. First State immediately informed Snap-On that its policy would not cover the punitive damage award. First State also engaged California counsel to investigate the loss.\(^{250}\) Meanwhile, Snap-On settled the Owens lawsuit while First State was still investigating the loss. Snap-On paid $1,000,000 to settle the punitive damage claim and $300,000 to settle the claims on which compensatory damages were awarded.\(^{251}\) Snap-On did not obtain First State’s approval of the settlement, and it did not inform First State of the settlement for several weeks.\(^{252}\) First State ultimately declined to indemnify Snap-On, asserting that Owens’ claim was not a covered “occurrence” as defined in the policy, that Snap-On’s notice of the loss was untimely, and that Snap-On failed to obtain its approval before settling the claim with Owens.\(^{253}\)

Snap-On responded by suing First State for bad faith and breach of contract in Wisconsin, where Snap-On was headquartered.\(^{254}\) Both parties moved for summary judgment, and the trial court entered summary judgment for Snap-On on its breach of contract claim.\(^{255}\) After several attempts to reverse the entry of summary judgment for Snap-On (with corresponding damages of $900,000), First State counterclaimed. First State alleged that Snap-On had breached the fiduciary obligations inherent in its manuscript policy and that Snap-On acted in bad faith.\(^{256}\) First State sought both compensatory and punitive damages in its counterclaim.

A lengthy trial was conducted on Snap-On’s bad faith claim against First State, and on First State’s breach of fiduciary duty and bad faith
counterclaims against Snap-On. The jury awarded Snap-On $250,000 in compensatory damages, but it did not award punitive damages.\footnote{257}{Id.} The jury also found that Snap-On acted in bad faith. The jury awarded First State $500,000 in compensatory damages. The jury further found that Snap-On had acted maliciously, or in wanton and willful or reckless disregard of its insurer’s rights, and awarded First State $4,000,000 in punitive damages.\footnote{258}{Id.} Both parties appealed.

The Wisconsin Court of Appeals held that the acts giving rise to Owens’ suit did not constitute an “occurrence.”\footnote{259}{Id. at *8-*9.} The court further held that Owens’ damages were not attributable to “personal injury” as defined in the policy.\footnote{260}{Id. at *9.} The \textit{Snap-On Tools} court thus concluded that the trial court erred in denying First State’s summary judgment motion.\footnote{261}{Id.} Because all of the other issues raised on appeal arose after the erroneous denial of First State’s motion for summary judgment on the fundamental issue of coverage, the \textit{Snap-On Tools} court deemed them “extraneous to the disposition of [the] case,” and declined to address them.\footnote{262}{Id.}

The \textit{Snap-On Tools} court’s failure to address First State’s reverse bad faith claim is unfortunate. While it is true that First State’s reverse bad faith claim did not become an issue until after the erroneous denial of its summary judgment motion, it still was harmed by its insured’s bad faith conduct. At the very least, Snap-On’s reverse bad faith caused First State to incur unnecessary defense costs and related expenses. The insurer should have been entitled to compensatory damages in some amount notwithstanding its successful coverage defense. The \textit{Snap-On Tools} court apparently failed to appreciate or understand the difference between the affirmative defense of comparative bad faith, and the insurer’s independent cause of action for reverse bad faith.\footnote{263}{Anderson, \textit{supra} note 19, at 531 (stating that the court failed to appreciate the distinction between comparative bad faith and the tort of reverse bad faith).}

In contrast, a Texas trial court embraced reverse bad faith in \textit{Pioneer Chlor Alkali Co. v. United Capitol Insurance Co.}\footnote{264}{No. 91-22014 (Tex. Dist. Ct., Harris County, Dec. 30, 1994), \textit{reported in} 9 MEALEY’S LITIG. REPORTS: INS. No. 10, H-I (Jan. 10, 1995).} The \textit{Pioneer} insured sued United Capitol in a declaratory judgment action arising out of the release of chlorine gas at the insured’s Nevada chemical
plant. The insured also alleged United Capitol’s breach of contract, bad faith, fraud, and misrepresentation.\footnote{Id.} The United Capitol policy at issue contained an absolute pollution exclusion which clearly excluded coverage for the loss.\footnote{Id.}

The presence and effect of the absolute exclusion were known, or should have been known, to the insured. The insured’s prior policies contained absolute pollution exclusions.\footnote{Id.} Additionally, the insured’s broker advised it nearly one year before the loss that it had no pollution coverage because of the absolute pollution exclusion in its policy.\footnote{Id.}

Despite knowledge that the occurrence was not covered, the insured prosecuted its action against United Capitol for nearly two years. The insured ultimately dismissed United Capitol on the first day of trial. The case then went to trial before the court on the insurer’s claims for attorneys’ fees under a Texas rule penalizing parties who prosecute groundless actions in bad faith.\footnote{Id.}

The Pioneer court concluded that the insured had, indeed, prosecuted a groundless action in bad faith.\footnote{Id.} It therefore entered judgment against the insured in the amount of $241,500, a sum which represented both the insurer’s attorneys’ fees and sanctions.\footnote{Id.}

Although Pioneer has little precedential value as a trial court judgment, it is a potentially important opinion because the court clearly expresses its pro-insurer rationale.\footnote{Id.} Pioneer is also significant because the court’s reasoning easily translates to other cases and disputes.

V. THE ROAD AHEAD

Continued travel on the two-way street of insurance good faith necessitates an examination of those situations that litigants are most likely to encounter. Whether examining insureds’ bad faith in the third-party or first-party context, or whether asserting the insured’s bad faith as an affirmative defense or as an independent cause of action seeking redress, it is useful to identify certain common scenarios. Once those scenarios are identified, the relative merits of insureds’ and insurers’ positions are open to debate.

\footnotesize{\begin{itemize}
\item 265. Id.
\item 266. Id.
\item 267. Id.
\item 268. Id.
\item 269. Id. (citing TEX. CIV. PRAC. & REM. CODE ANN. § 9 (West 1996)).
\item 270. Id.
\item 271. Id.
\item 272. Goldman, supra note 23, at 37.}

A. Identifying Situations in Which the Insured's Conduct Detrimentally Affects the Insurer's Rights

An insured may conduct himself or itself in such a way as to detrimentally affect an insurer's rights in both the third-party and the first-party context.

1. Third-Party Categories

An insured's conduct may detrimentally affect a liability insurer's rights in two situations. First, after the underlying occurrence, the insured's conduct may impair the insurer's ability to adjust, defend, or settle the claim. Second, after the carrier commits an act of bad faith, the insured's actions may enlarge or enhance the damages attributable to the insurer's wrongful conduct.

Conduct falling into the first category is easily illustrated. For example, an insured might attempt to conceal evidence or persuade friendly witnesses to mislead the insurer in an attempt to conceal coverage defenses. An insured with a SIR, with a policy right to consent to settlement, or with special account instructions giving it a settlement voice, might negligently or recklessly handle settlement negotiations and expose an insurer to liability that it would have otherwise avoided.

Assume that a commercial insured has a $100,000 SIR, with $1,000,000 in liability coverage above its retained limit. The insured is sued by an invitee who is seriously injured on the insured's property. The insured likely bears some fault for the plaintiff's injury. The plaintiff ultimately offers to settle the case for $85,000. The insured has every incentive to try the case, because its potential liability is capped at $100,000, while a jury may return a verdict considerably less than the plaintiff's offer. The insured's potential reward is far greater than its potential risk. The insurer, on the other hand, wants the insured to accept the plaintiff's settlement offer. If the insured accepts the plaintiff's offer, the insurer avoids all liability. In short, this is the stereotypical third-party bad faith scenario, but with the insured's and the insurer's roles reversed.

Alternatively, an insured may delay reporting an accident to an insurer. As a result of that delay, potentially valuable evidence is lost or destroyed, or important witnesses disappear. When the aggrieved third-party actually files suit, the loss of evidence or witnesses'
disappearance impairs the insurer’s ability to effectively defend its insured.

Excess carriers might be prejudiced by an insured’s post-occurrence conduct as well. For example, an insured might negotiate special account instructions with its primary insurer that give it the right to control the defense and settlement of certain categories of claims or suits. The insured may aggressively defend a suit in which the damages threaten to invade the excess coverage even when reason compels settlement within the primary policy’s limits. Given its unreasonable view of the defensibility of the action, the insured may see no need to alert the excess insurer to the suit or the threat it poses until the eve of trial. Absent timely notice, of which it has now been deprived, the excess carrier cannot reasonably evaluate its exposure or step in to defend or settle the case.

As for the second category of insureds’ conduct, the archetypal example is a collusive settlement following an insurer’s mistaken decision not to defend the insured. The insured and the plaintiff may then be free to enter into a settlement or stipulate to a judgment in which the plaintiff receives potential damages far exceeding any likely jury award in exchange for a covenant not to execute on the insured’s personal assets.

2. First-Party Categories

In the first-party context, an insured’s conduct may prejudice an insurer in at least three situations. First, the insured’s conduct may increase the severity or the probability of the underlying loss. Second, the insured’s conduct may impair the insurer’s ability to adjust or resolve the claim. Third, the insured’s conduct may increase the size or severity of the loss after the insurer breaches its contract, or its duty of good faith and fair dealing.

An insured may increase the size or severity of the underlying loss in the property insurance context by not maintaining the subject property or by changing the property’s use without the insurer’s knowledge or consent. An insured might allow commercial property to deteriorate in order to drive out existing tenants, with a corresponding increase in hazard. Or, an insured might misrepresent a commercial property’s intended use, causing the insurer to underestimate the risk.

275. Id.
276. Id.
277. Id.
With respect to the second category of conduct, an insured might conceal material facts from the insurer. An insured might also impair an insurer's subrogation rights, leaving the insurer responsible for a loss rightfully borne by a negligent third party.

Behavior falling into the third category can also pose problems for insurers. Suppose that once property is damaged and the insurer wrongfully refuses to pay, the insured determines that the insurer will ultimately be liable for all damages causally linked to its conduct. After the insurer's denial, then, the insured does not take steps to minimize the loss, even though it plainly would be reasonable or prudent to do so.

B. The Need to Recognize Comparative Fault and Comparative Bad Faith as Affirmative Defenses

The policyholders' bar advances a number of reasons why insurers should not be allowed to raise their insureds' comparative fault or comparative bad faith as affirmative defenses. These arguments, while valid to some extent, are not compelling.

The primary argument against the extension of comparative fault principles to the insurance bad faith arena seems to be the "disproportionate power of the parties to the [insurance] contract." Policyholders' advocates often argue that the insurer-insured relationship should not be compared to the relationships between parties in typical comparative fault situations because insurers generally draft the policies they sell without their insureds' participation. In addition, insurers enjoy far superior bargaining power. This unequal bargaining power could allow unscrupulous insurers to take advantage of their insureds. Insurance policies are, at base, adhesion contracts. Additionally, insurers, not insureds, are primarily responsible for discharging the insurance policy.

278. Brothers, supra note 23, at 1566.
279. Id.
Thus, insureds are not generally responsible for performing the contract.\textsuperscript{282} This traditional perspective is not uniformly true today. In many instances, insurers no longer have the upper hand.\textsuperscript{284} Average insureds generally enjoy increased power resulting from the many common law remedies available should an insurer act in bad faith. Many states protect insureds from predatory insurers by way of unfair claim practice statutes\textsuperscript{285} or under consumer protection statutes.\textsuperscript{286} "If anything, the scales tend to tilt in favor of the insured given the common law and statutory minefield that today's insurance companies must navigate."\textsuperscript{287}

Commercial insureds with substantial assets and ready access to legal services stand on equal footing with their insurers.\textsuperscript{288} Large commercial entities have significant bargaining power\textsuperscript{289} and are often able to negotiate for manuscript policies, special account instructions, and other favorable policy provisions. Such insureds often rely on sophisticated brokers or knowledgeable risk managers to negotiate their policies. The resulting policy is essentially bargained for at arms length, and it is not an adhesion contract.\textsuperscript{290} Thus, the rationale that supports protecting individual insureds does not always transfer to the

\textsuperscript{282} Brothers, \textit{supra} note 23, at 1566.
\textsuperscript{283} Id.
\textsuperscript{284} Anderson, \textit{supra} note 19, at 515.


\textsuperscript{287} Anderson, \textit{supra} note 19, at 515.


\textsuperscript{289} Livesay, \textit{supra} note 23, at 1215.

\textsuperscript{290} Id. at 1216.
commercial context. Depending on the commercial insured's size, sophistication, and wealth, there may be absolutely no need for judicial favoritism.

The second argument against the application of comparative fault principles to insurance bad faith is that insurers are already protected from insureds' negligent or bad faith conduct by traditional contract defenses. For example, an insurer might be able to defeat its insured's bad faith claim by arguing that the insured breached the cooperation clause in the policy, or that the insured failed to comply with the policy's notice of loss or proof of loss requirements. An insurer might also argue that the insured interfered with its subrogation rights. Most fundamentally, an insurer might argue that there was no coverage for the "occurrence" or loss at issue, and hence, it could not have acted in bad faith.

Although superficially appealing, leaving insurers to their contract defenses is practically and theoretically unsatisfactory for several reasons. Initially it must be noted that insurers may be liable for bad faith even in the absence of coverage for the underlying loss or occurrence. There may be situations, then, in which the insured's conduct might be factually relevant to the insurer's alleged bad faith conduct without qualifying as a contract defense. Additionally, an insured's conduct may not be deemed a material breach of a policy

291. Brothers, supra note 23, at 1567.
292. Id.
293. See, e.g., Viles v. Security Nat'l Ins. Co., 788 S.W.2d 566, 567 (Tex. 1990) (first-party claim); Safeco Ins. Co. of Am. v. Butler, 823 P.2d 499, 506 (Wash. 1992) (stating that an estoppel remedy offers better protection against an insurer's bad faith conduct). Texas has cooled to the idea of bad faith in the absence of coverage since Viles was decided. See Republic Ins. Co. v. Stoker, 903 S.W.2d 338, 341 (Tex. 1995) (noting that "as a general rule there can be no claim for bad faith when an insurer has promptly denied a claim that is in fact not covered"). However, the Stoker court acknowledged that an insurer could commit an act so extreme that it could be liable for bad faith even if the underlying claim were not covered. Id.

294. Pryor, supra note 23, at 1526.
provision such as a cooperation clause, yet it may still have influenced the insurer's behavior. The insured's conduct would thus justify comparison even if it did not provide an absolute policy defense. Finally, if the insured's conduct occurs after the insurer acts in bad faith, the insurer probably has no policy defenses. This is because the insurer's breach of contract will excuse the insured's performance. Therefore, the insured's negligent or wrongful conduct would have no defensive effect even when it directly bears on the harm for which the insured seeks recovery. Simply put, an insured should not fully recover when it partly or wholly caused the damages at issue.

Third, assuming that the insured's conduct is relevant to the determination of the insurer's bad faith liability, the evidentiary effect of the insured's conduct should be sufficient to safeguard the insurer's interests. Critics of comparative fault and comparative bad faith in the insurance realm contend that their application allows an insurer to use identical evidence to demonstrate the reasonableness of its conduct and, at the same time, compel a reduction in the insured's claimed damages. Allowing a reduction in the insured's damages because of her bad faith, despite the insurer's bad faith conduct, provides an insurer with two means of using the same evidence to its advantage. Comparative fault or comparative bad faith essentially amounts to a "double defense" for insurers.

This is perhaps the best argument against adopting comparative fault and comparative bad faith. However, the argument is not universally applicable. There may be situations in first-party cases in which the insurer's wrongful denial of a claim is at least partly the insured's fault. The fact that the insurer was at fault should not mean that the insured avoids liability altogether; after all, the insured was not free of fault. In the case of liability insurance, a third party that sets up an insurer for bad faith with a time-restricted settlement offer might be able to argue that its conduct is irrelevant in the absence of a specific affirmative defense of comparative bad faith or comparative fault.

On the other side of the coin, there are several forceful arguments to be made for allowing insurers to compare their insureds' conduct in bad faith litigation. First, recognizing affirmative defenses of

295.  Id. at 1525.
296.  Id. at 1527.
297.  WILLIAM M. SHERNOFF ET AL., INSURANCE BAD FAITH LITIGATION § 2.03[2][b], at 2-22 (1993).
298.  Id.
299.  Id.
300.  Pryor, supra note 23, at 1520.
comparative fault and comparative bad faith is fundamentally fair. Any award of damages should logically relate to the responsible parties’ conduct, not solely to the relationship between the parties.\textsuperscript{301} Holding insurers wholly liable for damages for which they are only partly responsible, while allowing insureds to recover for self-inflicted harm, offends all notions of equity and fairness.\textsuperscript{302} Comparative fault and comparative bad faith promote fundamental fairness by apportioning damages between responsible parties.\textsuperscript{303}

Second, courts cannot logically ground the duty of good faith and fair dealing in tort law and, at the same time, reject the concomitant and well-established affirmative defense of comparative fault.\textsuperscript{304} Fidelity to legal doctrine requires that if the implied duty of good faith and fair dealing merits tort remedies for its breach, so must it be subject to tort defenses.\textsuperscript{305} If courts are unwilling to recognize comparative fault and comparative bad faith, they should abandon tort theory and treat an insurer’s bad faith as a breach of contract.\textsuperscript{306}

Third, the application of comparative fault and comparative bad faith takes nothing away from blameless insureds, nor does it appreciably shield insurers that act in bad faith.\textsuperscript{307} Courts will not allow insurers to raise comparative fault and comparative bad faith as affirmative defenses,\textsuperscript{308} nor will they give related jury instructions, absent evidentiary support.\textsuperscript{309} Insureds’ meritorious bad faith claims will be unaffected. In most bad faith actions these defenses will not be an

\textsuperscript{301} Livesay, \textit{supra} note 23, at 1219.

\textsuperscript{302} \textit{Id.}

\textsuperscript{303} Anderson, \textit{supra} note 19, at 516; \textit{see also} Livesay, \textit{supra} note 23, at 1219 (noting that “[c]omparative bad faith restores fundamental fairness by shifting responsibility back to insureds for their misconduct”).

\textsuperscript{304} Richmond, \textit{supra} note 23, at 61.

\textsuperscript{305} \textit{Id.}

\textsuperscript{306} Several insurance law scholars have suggested that bad faith is properly confined to contract law. \textit{See}, e.g., Mark Gergen, \textit{A Cautionary Tale About Contractual Good Faith In Texas}, 72 TEX. L. REV. 1235, 1235-36 (1994) (extension of tort doctrine to contract disputes is unwarranted, especially when there are other means of remedying the breach); Jerry, \textit{supra} note 33, at 1342 (arguing that “tort law has infringed upon contract law’s rightful territory”); Robert H. Jerry, \textit{II, Remedy Insurers’ Bad Faith Contract Performance: A Reassessment}, 18 CONN. L. REV. 271, 319-21 (1986) (arguing that duty of good faith and fair dealing should be treated as a contract duty, but courts should administer contract remedies more flexibly in insurance cases); William Powers Jr., \textit{Border Wars}, 72 TEX. L. REV. 1209, 1229-31 (1994) (suggesting that tort duty of good faith and fair dealing is inappropriate in the first-party context).

\textsuperscript{307} Richmond, \textit{supra} note 23, at 60.


issue.\textsuperscript{310} Even in those cases in which the insured's conduct is suspect, insurers may be reluctant to assert the defenses. Jurors' general dislike for insurance companies, and the potential backlash that attends insurers' reliance on frivolous affirmative defenses, will limit insurers' use of comparative fault and comparative bad faith to those cases in which the insured's wrongful conduct is substantial or outrageous. At the same time, the defenses will discourage insureds from pursuing bad faith litigation where the insured's conduct aggravated the underlying situation or in which the insured's conduct materially contributed to the loss.\textsuperscript{311}

Fourth, comparative fault and comparative bad faith serve to discourage insureds who might otherwise be tempted to set up their insurers for bad faith claims. Judicial recognition of comparative fault and comparative bad faith discourage insureds from filing frivolous declaratory judgment or bad faith actions. Comparative fault and comparative bad faith would thus restore some reason to today's hostile insurance litigation climate, in which every bad faith and declaratory judgment action is a potential bonanza for the insured. These defenses also serve to penalize insureds who are pursuing fraudulent claims, and who would otherwise profit from their deceit if the insurer could not satisfy its burden of proof on a concealment or fraud defense.\textsuperscript{312} The economic benefit of combating or discouraging insurance fraud cannot be disregarded; insurance fraud costs society some $20 billion annually and it significantly increases premium costs.\textsuperscript{313}

\textbf{C. The Need to Recognize Reverse Bad Faith}

To date, no appellate court has published a decision recognizing reverse bad faith as a cause of action absent a statute conferring the right to bring such a claim.\textsuperscript{314} That does not mean, however, that insurers should give up on the idea of reverse bad faith or that such a cause of action is not viable. As the \textit{Greater New York Mutual Insurance Co. v. North River Insurance Co.}\textsuperscript{315} court observed, "[a]n insured should not have license to act in bad faith toward its

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{310} Anderson, \textit{supra} note 19, at 519.
\item \textsuperscript{311} Livesay, \textit{supra} note 23, at 1218.
\item \textsuperscript{312} \textit{Id.} at 1219.
\item \textsuperscript{313} \textit{Id.} at 1219.
\item \textsuperscript{315} 872 F. Supp. 1403 (E.D. Pa. 1995), \textit{aff'd}, 85 F.3d 1088 (3d Cir. 1996).
\end{enumerate}
\end{footnotesize}
insurer.  

At the very least, the reciprocal duty of good faith and fair dealing implied in all insurance policies should entitle an insurer to recover contract damages occasioned by its insured’s bad faith.  

The strongest argument for recognizing a reverse bad faith cause of action can be made where the insured commits fraud when making a claim under a first-party policy. In that situation, equity clearly favors the insurer. The insurer must devote human resources and expend capital to investigate and resolve a claim made solely to reap an unfair and unintended economic windfall. The insurer must devote its time and spend its resources on a claim attributable to a risk for which it did not bargain. Such wrongful conduct by an insured should support a compensatory damage award, and it may also justify a punitive damage claim by the insurer.

If an insured submits a fraudulent first-party claim and then sues the insurer for bad faith when the claim is denied, a reverse bad faith cause of action is practically mandated. Under these circumstances, the insurer must bear the cost of defending the bad faith action and face related damage exposure when it has already been forced to bear the expense of adjusting the underlying claim. Especially in situations where the insurer may not be able to prove fraud or malicious prosecution, it should be allowed to counterclaim for the tort actually committed by the insured.

A powerful argument can also be made for recognizing a reverse bad faith cause of action in those third-party cases in which the insured or, more likely, the insured’s assignee, sets up the insurer for a bad faith claim. Here again the insurer must bear allocated adjustment expenses for the underlying liability claim. The insurer must also bear the cost of defending its insured in the underlying third-party action. The insurer must defend the bad faith action knowing that it can spare no defense-related expenses because of the threat of ruinous extracontractual liability. Finally, the insurer is exposed to unearned and unjustified extracontractual liability that may ultimately cause it to settle other claims that it ought not, simply because of the lingering bad faith threat. Any third-party bad faith claim that is “set up” should entitle the insurer to both compensatory and punitive damages.

316. Id. at 1408.
317. Id.
318. Richmond, supra note 23, at 69.
319. Id.
320. Id.
321. Id.
322. Id.
An insurer might also be justified in suing for reverse bad faith where an insured sues for coverage under the policy knowing that the underlying claim is not covered or where the insured reasonably should have so known. This was, of course, the situation presented in Pioneer Chlor Alkali Co. v. United Capitol Insurance Co. While this situation may not carry with it the threat of extracontractual liability—assuming the insured simply seeks a declaratory judgment or alleges a mere breach of contract—the insurer nonetheless has to spend time and capital defending frivolous litigation.

In all of these scenarios the insured’s power, wealth, sophistication, and size are irrelevant. There is no need for preferential or protective treatment. The focus in these situations comfortably and properly rests on the insured’s conduct and not on the insured’s status.

D. Pleading the Insurer’s Defense or Claim

In most instances an insurer should have no difficulty pleading the insured’s comparative bad faith or comparative fault as an affirmative defense. In federal courts and in those jurisdictions that allow notice pleading, an insurer may allege one or both defenses very generally. Indeed, an insurer may want to allege both defenses in order to make sure it preserves a defense that will survive discovery and dispositive motions. In fact-pleading jurisdictions, a defending insurer will have to specify those facts on which the defenses are premised. A key determinant regardless of the jurisdiction’s pleading rules is the bad faith standard against which the insured’s conduct should be measured. In those jurisdictions applying a negligence standard in bad faith cases, the insurer probably should plead the insured’s comparative fault, rather than comparative bad faith.

In addition to pleading comparative bad faith and comparative fault, a defending insurer should also be sure to plead related affirmative defenses. Such affirmative defenses may include recoupment, setoff, and breach of the policy’s cooperation clause.

An insurer wishing to assert a reverse bad faith cause of action will probably have to plead it as a counterclaim. In most instances, reverse bad faith will be a compulsory counterclaim; the same nucleus of operative facts giving rise to the insured’s bad faith claim will form the basis for the insurer’s reverse bad faith allegations. In the first-party context an insurer should allege (1) that the insured owes it a duty of


324. See supra note 98.
good faith and fair dealing as a party to the contract of insurance, (2) that the insured breached the duty, specifying the insured's offending conduct as best as it can be pleaded, and (3) that the insurer was damaged as a result of the insured's breach. In third-party cases, the insurer probably will be required to allege that, as an assignee, the third-party claimant steps into the insured's shoes, thereby becoming subject to all claims that might otherwise be made against the insured.

Insurers must be selective in raising the affirmative defenses of comparative bad faith and comparative fault, and in asserting reverse bad faith claims. Frivolous affirmative defenses are likely to anger jurors, thus increasing the insurer's exposure instead of potentially reducing the insurer's damages. Insurers opting to pursue reverse bad faith claims must be able to point to particularly offensive conduct by insureds in order to justify the expense associated with prosecuting such a lawsuit.

VI. CONCLUSION

Courts' and juries' enforcement of the duty of good faith and fair dealing inherent in every insurance policy has been decidedly unilateral. Assuming the duty of good faith and fair dealing to be a two-way street, as it truly is and was meant to be, why have insurers not had greater success pleading insureds' bad faith as an affirmative defense or as a separate cause of action? Part of the problem lies in outmoded judicial notions of the insured-insurer relationship, and part is probably attributable to insurers' reluctance to raise or rely on largely untested legal theories in bad faith cases.

Regardless of the source of existing doctrinal difficulties, travel on the two-way street of good faith has been rough thus far. Much work remains to be done before the street is truly open to insurers; yet, there is no doubt that it should be. Fairness and fundamental legal principles require that work continue and that insurers' route be cleared.

325. See supra Part II.
326. See supra Part III.
327. See supra Part III.
328. See supra Part IV.
329. See supra Part V.
330. See supra Part V.
331. See supra Part V.