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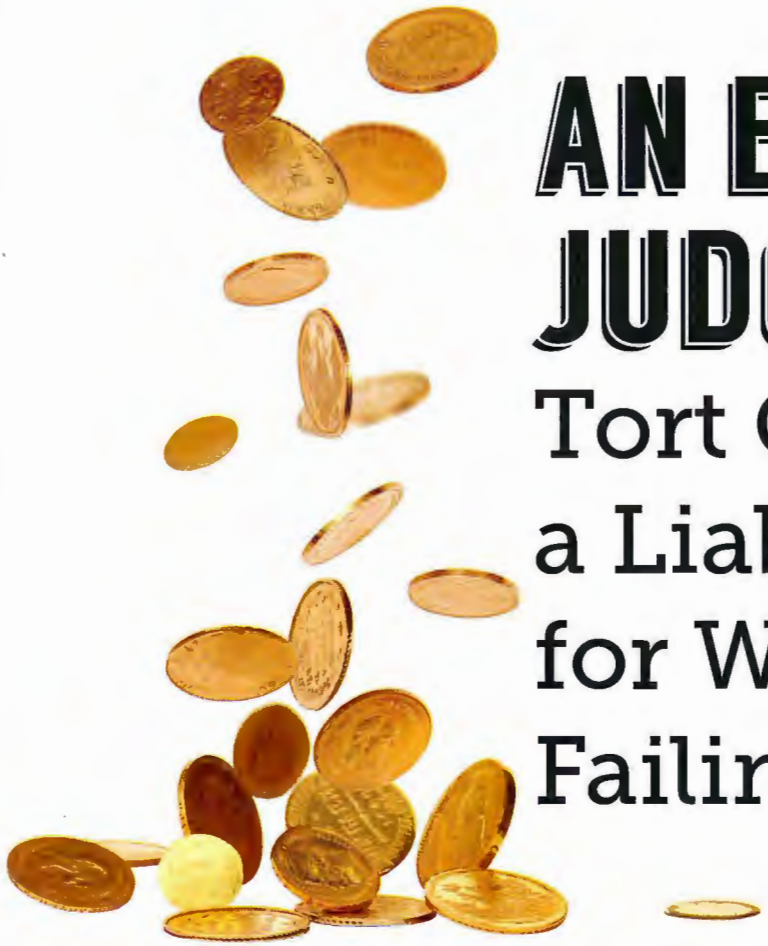

AN EXCESS JUDGMENT CASE:

Tort Claims Against a Liability Insurer for Wrongfully Failing to Settle

By Keith T. Belt Jr.

The subject paper will primarily address the third-party bad faith failure to settle tort. This cause of action potentially arises on behalf of an insured when a jury verdict in an amount that exceeds their available policy limits is entered against them. Although this paper discusses the Alabama tort of negligent failure to settle, it is not thoroughly addressed and the author would encourage lawyers who handle Plaintiff's cases to thoroughly familiarize themselves with that tort.[1] The combination of these two torts—negligent and bad faith failure to settle—are two of the most powerful weapons in a trial lawyer's arsenal. First, the mere threat of these torts can create enormous settlement leverage to help the practitioner negotiate a favorable settlement. Second, the torts provide the insured with a remedy that will allow him to recover the amount of the excess verdict and recover his own damages for mental anguish and possibly punitive damages.

In order to apply the proper legal standard in a third-party bad faith case, the practitioner must understand the distinction between first and third party bad faith. The distinction hinges on the relationship between the original claimant and the insurance company and is discussed thoroughly below. Understanding this distinction is critical because the legal standard for first versus third-party bad faith in Alabama is very different.

I. The Problem.

The bargain at the core of every liability insurance contract is that the insured pays premiums to the insurer in exchange for an agreement that the insurer will defend and (if necessary) settle specified liabilities of the insured within the agreed liability limits. Regular policy provisions (drafted by the insurer) give it the power and discretion (1) to control the defense of any lawsuit against the insured and (2) to decide whether a claim will be settled within policy limits. The policy will impose on the insured duties to cooperate with the insurer. If the insured fails in the performance of these duties, typical policy provisions allow the insurer to void coverage. However, there are no policy provisions that attempt to dictate when an insurer must settle much less penalize the insurer for failure to perform its duties to defend and settle.

Consequently, the insured often has no remedy for breach of contract against the insurer if the insurer does not take its fiduciary duties seriously and fails to settle. This can be a problem for insureds because although the insurer has an economic incentive to act with reasonable care in settling cases where the insured's top-end exposure is within policy limits, the insurer has no real economic incentive, per the policy, to protect the insured when the insured's top-end exposure approaches or exceeds policy limits.

II. The Solution.

Fortunately, for sixty years, the common law has provided a remedy for insureds who suffer a judgment in excess of policy limits when their liability insurer has wrongfully failed to protect their insured's financial interests. The case of Waters v. Am. Cas., 73 So.2d 524, 528-529 (Ala. 1954) recognized the tort causes of action for (1) negligence and (2) bad faith, holding that "it is a question for the jury from all the facts and circumstances to determine whether the failure on the part of the insurer to make a settlement is an act of negligence or one of bad faith." The court did not deem it necessary to opine further about the application of "negligence" or "bad faith," given that the terms had "well understood meaning[s]." Id. It observed, though, that bad faith "is tantamount to an intentional failure to

perform [required] duties." Id. On rehearing, however, the court accepted the invitation to elaborate upon "the application of the rules of negligence and bad faith" in third-party cases:

> A failure to exercise ordinary diligence proximately causing damage to the insured is actionable in tort. The contract of insurance gives the insurer the exclusive right to make a settlement of the claim against [the] insured. That right imposes a corresponding duty raised by law to observe ordinary diligence in performing that power, when in the exercise of it. So that, when an opportunity is presented to the insurer to make a settlement of the claim in an amount not more than the limit of liability, the law raises a duty on his part to use ordinary care to ascertain the facts on which its performance depends if he has not already done so. If the insurer neglects to exercise ordinary diligence in ascertaining these facts, if he has not already done so, and as a proximate result of such neglect he fails to make such a settlement, which is available, and when such knowledge would have caused a reasonably prudent person to do so, and a verdict and judgment are rendered against insured in an amount more than the limit of liability in the policy, the insurer should be held liable to the insured for the full amount of the judgment. If the insurer has already made the investigation and ascertained the facts, to which we have referred supra, and refuses to make such proffered settlement, if such refusal is due to the honest judgment of insurer that the facts do not warrant such a settlement, and the insurer was not negligent in the manner of defending the suit, he would not be liable to [the] insured for an amount in excess of the limit of liability provided in the policy, although the verdict and judgment were in excess of it. But if such refusal to settle under those circumstances is the proximate result of bad faith on the part of the insurer, he would be liable for the full amount of the judgment, notwithstanding it is in excess of the limit fixed in the policy[2]

Thus, the Waters decision imposes upon a liability insurer a duty to use ordinary care in the exercise of its exclusive right to settle a third-party claim against its insured and held that whether the insurer acted negligently or in bad faith in the exercise of its settlement authority depends upon "all the facts and circumstances." While negligence and bad faith are separate torts, the Waters decision reveals that the same facts and circumstances are relevant to determining the degree of the insurer's culpability, namely, whether the insurer has acted negligently or in bad faith.[3]

III. The Difference between First and Third Party Bad Faith.

The difference between a negligent failure to settle claim and a bad faith failure to settle claim is obvious. Successful proof of the latter presents the opportunity for the assessment of punitive damages while the former does not. While the same facts and circumstances are relevant for determining the degree of the insurer's culpability, namely, whether the insurer has acted negligently or in bad faith, obviously worse conduct on behalf of the liability insurer must be established to obtain punitive damages for bad faith. Liability insurers will argue that a claimant must also prove the additional element that there is no arguable or debatable reason for its failure to settle for a bad faith claim (i.e. the "debatable reason test") to be successful. Under this test, if the insurer has an "arguable or debatable reason" to deny or delay in paying a claim, there is no bad faith. Considering that the "debatable reason test" is by far the most discussed topic in the vast majority of the reported bad faith decisions, the initial reaction of many practitioners is agreement with this proposition. However, such a proposition is false. The law is clear that bad faith failure to settle claims are resolved under the "totality of circumstances test" enunciated in Waters and not the "debatable reason test." To understand why this is so, the practitioner must understand the distinction between first party bad faith and third party bad faith, and there is a big difference. The distinction hinges on the relationship between the claimant and the insurance company and whether there is a fiduciary relationship.

In a first party bad faith case, the original claimant (i.e. the one seeking money) has a contractual relationship with the insurance company and is trying to recover that money directly from the insurance company. This type of bad faith can arise in the context of fire/storm casualty insurance claims and medical/disability claims. In a third party bad faith case, the original claimant does not have a contractual relationship with the insurance company. Instead, the original claimant is trying to recover money from the defendant-insured, and it is the defendant-insured that has the contractual relationship with the insurance company. As stated in the opening sentences of this paper, that contractual relationship is a contract of liability insurance where the liability insurer agrees to defend and indemnify/settle within policy limits. In the first party dynamic, insureds have nothing more than a traditional adversarial contractual relationship with their insurer. However, in a third party dynamic, not only is there a contractual relationship, the liability insurer also undertakes a duty to protect its insured's financial interests from attack by a third-party (i.e. the original claimant). Simply put, "in a typical [liability] insurance contract, the insured expressly relinquishes to the insurer the right to control the defense and settlement of any action arising under the contract."[4] As such, "[t]he insured's reliance on the abilities and the good faith of the insurer is therefore necessarily at a maximum." Id. Because of the policy language, the insured typically cannot settle the case against them nor do they have any control over their defense. In other words, the policy language leaves the insured powerless and totally dependent on the insurance carrier to protect her interests. The existence of this fiduciary relationship in the third party dynamic – which does not exist in first party cases -- is the reason why the "debatable reason test" does not apply in the third party context. Rather, the "debatable reason test" only applies to first-party bad faith claims and the "totality of circumstances" test applies to third-party bad faith claims, including bad faith claims for failure to settle. This result is clear upon close examination of the cases.

IV. The Caselaw (Third Party Cases).

The law available in third party bad faith cases is scant as there are very few

reported opinions because these cases do not arise very often. The first and most important is the Waters case where the court held:

> The contract of insurance gives the insurer the exclusive right to make a settlement of the claim against the insured. That right imposes a corresponding duty raised by law to observe ordinary diligence in performing that power, when in the exercise of it. So that, when an opportunity is presented to the insurer to make a settlement of the claim in an amount not more than the limit of liability, the law raises a duty on [its] part to use ordinary care to ascertain the facts on which its performance depends if [it] has not already done so.

The Waters Court stated that "properly drawn counts based either on negligence or bad faith should be held good," that the two claims "constitute different concepts," and that "either may exist without the other." The Court held (1) a negligent failure to settle can be proven if "the insurer failed to exercise ordinary care on the one hand or good faith on the other" and (2) a bad faith failure can be proven if there is "an intentional failure to perform those duties." Furthermore:

> [I]t is a question for the jury from all the facts and circumstances to determine whether the failure on the part of the insurer to make settlement is an act of negligence or one of bad faith. Both of those terms have a well understood meaning, and we do not see any reason why we should stumble over their application.

Twelve years later, the Court decided Hartford Acc. v. Cosby, 173 So.2d 585 (Ala. 1965), another third party failure to settle case. After quoting substantially from Waters, the Cosby Court held:

> [A]s to proof of the issue of bad faith, ... the insurer cannot escape liability by acting upon what it considers to be for its own interest alone, but it must also appear that it acted in good faith and dealt fairly with the insured. The insurer, as it had a right to do under the policy, assumed exclusive control of the claim against the insured, and took unto itself the power to determine for the insured all questions of liability, settlement, of defense and management before and during trial, and of appeal after final judgment. We are of the opinion that this relationship imposes upon the insurer the duty, not under the terms of the contract strictly speaking, but because of and flowing from it, to act honestly and in good faith toward the insured. It was open to the jury to find that the insurer did not perform this duty.[5]

"When an insurer intentionally, or 'in bad faith' fails to settle a third-party claim within its insured's policy limits, and the plaintiff satisfies the requirements of [A.P.J.I.] 11.03 [which states in lay terms the requirements of punitive damage statute, Ala. Code § 61120], the [insurer] may also be liable to its insured for punitive damages ... ."[6] The most widely respected treatise on Alabama liability insurance law, Allen's Alabama Liability Insurance Handbook, explains that a third party bad faith case is proven when a simple inference can be drawn "from all the facts and circumstances" that the insurer "act[ed] ... for its own interest alone" and "intentional[ly] fail[ed]" to "settle a third-party claim within its insured's policy limits."

No discussion of Alabama third-party bad faith failure to settle law would be complete without discussion of Judge Guin's detailed and scholarly opinion in Carrier Express v. Home Indemnity, 860 F.Supp. 1465 (N.D. Ala. 1994). In denying the defendant insurer's post-judgment motions in that case, Judge Guin stated that:

> In more than fortysix years of experience at bench and bar, the court has never seen a more egregious example of bad faith than the one presented in this case. It was a textbook case of bad faith refusal to settle, an astonishingly complete catalogue of ways for an insurer to breach its duty to its insured. Only by attending the trial or by reading the entire trial transcript can one grasp the extensiveness and utter outrageousness of the wrongdoing on the part of [the liability insurer].[7]

Some of the ways in which Judge Guin found that the insurer violated its good faith obligation to its insured included performing a shoddy and tardy investigation of the claims, failing to meet its duty of apprising the insured of developments in the case, concealing information from its insured, treating the decision about settlement "as solely its own, placing its interests above those of its insured and heedlessly disregarding the position of financial peril in which the underlying cases placed its insured," making "a dishonest, unsound, incompetent, subjective, self-serving decision in refusing to settle the underlying cases," and "recklessly gambl[ing] with the continued existence of its insured." Judge Guin charged the jury with eighteen factors to consider in determining whether the insurer acted in bad faith.[8] They were drawn from factors used by the plaintiffs' experts who testified in that case about the standard of care in the liability insurance claims industry, including then-Professor Karon Bowdre, who now sits as the Chief Judge of the Northern District.[9]

Five years after Carrier Express, while she was still a law professor and not yet a district judge, Bowdre wrote a law review article about the tripartite attorney-client relationship between the liability insurer, its insured, and defense counsel.[10] In her article, Judge Bowdre drew a correlation between claims for third party bad faith failure to settle and a liability insurer's enhanced duty of good faith per L&S Roofing v. St. Paul, 521 So.2d 1298 (Ala. 1987) when it defends under a reservation of rights:

> Because the enhanced obligation of good faith attaches to a reservation o frights defense provided pursuant to a liability policy, it is most akin to third-party bad faith. The good faith duty to settle and the enhanced obligation of good faith both rest on the fiduciary obligations of the insurance company who undertakes control of the defense of the insured. Because settlement frequently becomes an issue in reservation of rights cases, the good faith standard for evaluating settlements in the third-party bad faith cases applies to reservation of rights cases with some modifications. ... [A]n inadequate investigation can indicate bad faith when an insurance company refuses to settle an appropriate case.[11] [12]

Consequently, when there is a probability of an excess verdict, there is arguably an even greater danger to an insured

than when the insurer issues a reservation of rights. At least when an insurer issues a reservation of rights letter, the insured knows that the insurer may not be acting in her best interest. However, when an unsuspecting and unsophisticated insured does not understand how this all works and does not even contemplate what an "excess verdict" means, she does not even get this red flag that the insurer may not be looking out for her interests.

It is important to note that Judge Bowdre cited to the Carrier Express factors as the proper indicia for the jury to evaluate third party bad faith.[13] Judge Bowdre is not alone. Moreover, the Alabama Pattern Jury Instructions, the Allen treatise, and former Chief Judge Alex Howard of the Southern District have all recognized the Carrier Express factors as authority in third party bad faith failure to settle cases.[14] None of these third party bad faith cases impose a burden on the plaintiff to establish that the liability insurer lacked an arguable or debatable reason for not settling the claims within policy limits.

V. The Caselaw (First Party Cases).

The Alabama Supreme Court has always kept the legal analysis for third party bad faith cases separate from first party bad faith cases, and they were separate from the very start. When the Supreme Court recognized the first party bad faith tort in Chavers v. National Security, 405 So.2d 1, 5 (Ala. 1981) -- over twenty-five years after it recognized the third party bad faith failure to settle tort in Waters -- it did not overrule Waters and its progeny. To the contrary, the Chavers Court recognized third party bad faith was grounded in different public policy considerations than first party bad faith:

> In third party actions involving liability coverage, ... this Court has consistently allowed recovery against the insurer in situations where the insurer wrongfully refuses, either negligently or intentionally, to settle the third party claim within policy limits and where, as a result, the insured incurs a judgment against him in an amount in excess of the policy. ... The law applicable to first party actions involving a direct claim by the insured is not so well settled. Although this Court has neither accepted nor rejected the tort of bad faith in first party actions, we have indicated an increasing willingness to recognize such a cause of action given the appropriate circumstances.

(citations omitted). In articulating the elements of the new tort, the Chavers Court held that "we adopt the test promulgated by the dissent in Vincent v. Blue Cross, 373 So.2d 1054 (Ala. 1979) and hold that an actionable tort arises for an insurer's intentional refusal to settle a direct claim where there is either "(1) no lawful basis for the refusal coupled with actual knowledge of that fact or (2) intentional failure to determine whether or not there was any lawful basis for such refusal."[15] This was the first mention of what later became known as the "arguable and debatable" test. In Vincent, a three judge minority wanted to recognize first party bad faith. They eventually became the Chavers majority. Their opinion in Vincent is clear, however, that first party bad faith was clear and distinct from third party bad faith failure to settle:

> As stated in Childs v. Mississippi Valley, 359 So.2d 1146 (Ala. 1978), the tort of bad faith has neither been accepted nor rejected in first-party actions in Alabama. The tort has, however, been recognized in third-party actions where an insurer wrongfully refuses to settle a third-party claim within policy limits, and such refusal results in a judgment against the insured in excess of policy limits. In Waters, this court held that if a contract of insurance does not by its terms require the insurer to perform its duties with reasonable care, the law will impose such a requirement. "Bad faith" was defined as the intentional failure of the insurer to perform the duties at all. ... [However, the] cause of action made available in third-party actions by the holding in Waters was not extended to first-party actions by an insured.[16]

Thus, third party bad faith jurisprudence and first party bad faith jurisprudence were separate in Alabama from the beginning of first party bad faith. The "arguable and debatable" test solely applies to first party bad faith cases, not third party bad faith cases. This separation continued on in later cases. In Evans v. Mutual Assurance, 727 So.2d 66 (Ala. 1999), a third party bad faith failure to settle case, the Court analyzed when the bad faith cause of action accrued for statute of limitations purposes. The Court rejected the plaintiff's reliance on first party bad faith cases for the proposition that the claim should accrue when "the insurer first exhibits a bad faith failure to settle," holding:

> Each of those cases, however, involved a first-party claim wherein the insured alleged that the insurer had, in bad faith, refused to pay a legitimate claim made by the insured on his own policy. ... We find no basis for substituting the accrual rule applicable in first-party cases for the established accrual rule applicable in causes of action based on an insurer's failure to settle third-party claims against its insured.[17]

As noted above, the dynamics of the first and third party tort are completely different. In first party situations, if the insured does not agree with the insurer's construction of the contract, she can sue for breach of contract, and if she is correct, she can recover what is due. In the third party situation, however, the insured is powerless to defend herself and the bad faith tort is needed to encourage the insurer to protect the insured from harm from others. That is why insureds pay liability premiums. In her article, Bowdre explained the difference between third party bad faith failure to settle and first party bad faith. She also indicates that the arguable and debatable test only applies to first party bad faith cases:

> Bad faith as a separate tort action against an insurance company was first recognized in the context of an insurance company's refusal to settle a liability case against its insured. This cause of action arose from the fiduciary obligations undertaken by the insurance company when it defends the insured under a policy of liability insurance. By the terms of the liability insurance contract, the insurance company retains the right to control the defense of the insured and to decide whether to settle the claim against the insured. Those fiduciary duties support the duty to act in good faith toward the insured when evaluating settlement options. Inherent in this duty of good faith is

the obligation to adequately investigate the claims against the insured, hire competent counsel to defend the insured, and evaluate settlement options by giving at least equal consideration to the interests of the insured. Because this cause of action involves the defense of the insured pursuant to a liability insurance contract, it is known as "third-party bad faith" or "bad faith failure to settle."

A more recently recognized bad faith cause of action arises in the context of first-party insurance coverage, such as life, health, and property. First-party bad faith, or bad faith failure to pay a claim, requires a showing of the existence of an insurance contract that the insurance company breached by refusing to pay the claim without reasonably debatable grounds for denying the claim.

...

The **only** considerations in evaluating settlement [in a third party case] should be [1] the victim's injuries, [2] the probable liability of the insured, and [3] the likelihood that the ultimate judgment will exceed policy limits. As one court noted, "[s]uch factors as the limits imposed by the policy, a desire to reduce the amount of future settlements, or a belief that the policy does not provide coverage, should not affect a decision as to whether the settlement offer in question is a reasonable one." [18]

In § 13.13 of the Allen treatise, entitled "Distinction Between First-Party Claims of Bad Faith Against Insurer and Third-Party Claims Against Insurer," the author explains:

In order to make a jury issue as to bad faith in a first-party action, the insured plaintiff "must go **beyond** a mere showing of nonpayment and prove a bad faith nonpayment, a nonpayment without any reasonable ground for dispute." Or, stated differently, "the plaintiff must prove that the insurer had no legal or factual defense to the insurance claim."

However, there is no such requirement in a third party bad faith case. Id. There is no Alabama case where the arguable and debatable test has ever been applied to dispose of a third party bad faith failure to settle case. It just simply has not been done.

Based on all of the foregoing authority, it would be contrary to public policy and illogical to apply the "arguable and debatable" test to third party failure to settle bad faith cases. The whole point of this tort is to require the insurer to make a full and honest evaluation of the risk to the insured. If the insurer could eschew liability by merely forcing the insured to be vulnerable to an excess verdict with just a mere "arguable" defense, it could always avoid settlement, gamble with the insured's financial future and force litigation to a conclusion, even in cases like this one where there is no policy defense, only a hope that the insured will not be found liable, and the insured bore an enormously disproportionate share of the risk. Application of the "arguable and debatable" test to third party bad faith cases would eviscerate the tort and return the law back to its pre-Waters state.

VI. The Outlier Opinion.

As noted above, although the legal standard for bad faith is very different in first party and third-party cases, some courts have confused the legal standard. This confusion has occurred because the vast majority of the published opinions are first party cases. Consequently, when a lawyer encounters what he or she perceives is a bad faith case and researches "bad faith" law, the vast majority of the opinions encountered are first party cases and the lawyer often does not realize that the legal standard in a third-party case is different. In many cases, the reported opinion does not necessarily classify the bad faith claim as either first or third party. Many times you must read the facts to determine whether it is first or third party bad faith.

As a result, there is an Alabama Supreme Court opinion that, albeit in dicta, misstates the third-party legal standard. The case is Mutual Assurance Inc. v Schulte, 970 So.2d 292 (Ala. 2007). In this case, the court referenced a third-party bad faith claim and stated, "the inquiry relevant to a claim alleging bad faith failure to settle is whether the insurer's failure to settle had any lawful basis, that is, whether the insurer had any legitimate or arguable reason for failing to pay the claim." Id at 296. Although this language appears to mirror the arguable and debatable test for 1st party bad faith, that test has no application in a third-party bad faith case. Fortunately, this misstatement of third-party bad faith law was dicta.

In Schulte, two medical providers filed suit against their liability insurer after it refused to settle a malpractice claim against them, which ultimately resulted in a judgment exceeding the liability limits of their policy. They asserted two claims, one for negligent failure to settle and another for bad faith failure to settle. After the trial court denied MAI's motion for a summary judgment, the Alabama Supreme Court allowed interlocutory appeal pursuant to A.R.A.P. 5. On appeal, the insurer argued that it was entitled to summary judgment on both claims because it had an arguable and debatable reason to not settle the third party suit. With little analysis, the Court stated that the bad faith claims were allegedly subject to the arguable and debatable test but that the negligence claims were not.

In any event, the Supreme Court affirmed the circuit court's denial of summary judgment on the negligence claims because it was not subject to the arguable and debatable reason test. Significantly, however, the Court did not reverse the circuit court on its denial of Summary judgment on the bad faith claims. The parties had an agreement that if the Supreme Court did not accept the insurer's arguments then the liability insurer would pay the excess judgment and the litigation would be ended. Because of this agreement and the fact that the plaintiffs were "willing to abandon their claims for additional compensatory damages and/or punitive damages," the Court held that "we need not consider the bad faith failure to settle claim," and that "[w]e express no opinion as to that part of the trial court's order denying [the insurer's] summary judgment motion as to the bad faith failure to settle claim because our decision on the negligent failure to settle claim and the unique procedural posture of this case renders a review of that claim unnecessary."[19] Therefore, the discussion of the arguable and debatable test in the context of third party bad faith actions by the Schulte Court was dicta. "Because obiter dictum is, by definition, not essential to the judgment of the court which states the dictum, it is not the law of the case established by that judgment."[20]

Nor is Schulte even good persuasive

authority for the proposition that the arguable and debatable test should apply to third party bad faith cases considering this issue was not really analyzed in that case. Indeed, it is clear that the Supreme Court's statements in Schulte regarding the applicability of the arguable and debatable test to third party bad faith claim for failure to settle was not really studied at length by that Court. In fact, the two cases cited in support of the proposition that arguable and debatable would apply in the third-party context are not even third party cases.[21] The two first party bad faith claims cited for that proposition are National Security v. Bowen, 417 So.2d 179 (Ala. 1982)(first party bad faith claim concerning a casualty claim against a property insurer for stolen property) and Gulf Atlantic v. Barnes, 405 So.2d 916 (Ala. 1981)(first party bad faith claim concerning a claim against a life insurer for failure to pay children's rider benefit). In both of these first party cases, discussion of the arguable and debatable test was clearly limited to the first party context.[22] Nor is there any indication that the Schulte-plaintiffs informed the Court of the distinction between first party and third party bad faith.

Moreover, the Alabama Supreme Court has made statements in a subsequent holding that are inconsistent with the Schulte dictum. As recently as 2012, the Court has recognized that "the alleged separate methods of proof for negligent and bad faith failure to settle a third party liability insurance claim] are not material," that "liability is the same under either theory," and "regardless of the theory of recovery or the method of proof, the measure of damages is the same for each."[23] Drawing a parallel between these two causes of action necessarily distinguishes it from first-party bad faith.

VII. The Clarification.

In addition to Judge Bowdre, we have a recent decision by another learned jurist who further clarifies the standard in third party bad faith cases. In Franklin v. Nat'l Gen., 2015 WL 350633 (M.D. Ala. 2015), Chief Judge Keith Watkins of the U.S. District Court for the Middle District of Alabama held that the "totality of circumstances" test, and not the "debatable reason test," applies to third party bad faith failure to settle cases. Tracing the origins of the bad faith tort back to Waters, Judge Watkins noted that the third party variety was the "first born." In holding that a different test was applicable, he concluded that:

> On the basis of the Alabama Supreme Court's decisions in Waters, Cosby, and Hollis, the court finds untenable [the defendant liability insurer's] position that an insurer is not liable on a third-party bad-faith claim where it has an arguable or debatable reason to deny a claim. Neither Waters nor Cosby nor Hollis mentions an arguable-reason test[15] as an element of a plaintiff's third-party claim or suggests that an insurer can prevail if the insured cannot show the absence of an arguable reason for the insurer's refusal to accept a policy-limits settlement of the claim against the insured by a third party. To the contrary, these decisions command a totality-of-circumstances approach. See, e.g., Waters, 73 So.2d at 529 (holding that whether an insurance company acted in bad faith in the exercise of its settlement authority depends upon "all the facts and circumstances").

Additionally, in Waters, the court rejected an argument similar to the one that NGAC makes in this case. In Waters, the insurer had argued that the insured should be "estopped" from asserting that the insurer "was guilty of bad faith or negligence in his decision to try the case ... and not to settle" it because the insured consistently maintained in the underlying action that he had not been negligent. See 73 So.2d at 531. The court disagreed, opining that "[t]hese facts were for the consideration of the jury along with all the other facts and circumstances of the case." Id. (emphasis added). Waters indicates that an insurer's pre-suit refusal to settle a third-party's claim against its insured based upon the insured's headstrong denial of liability is a factor, but it is not the only factor relevant to the inquiry of whether the insurer engaged in bad faith in the evaluation of a third-party settlement offer. Hollis confirms Waters's stance. See Hollis, 554 So.2d at 391 ("While the view of the carrier or its attorney as to liability is one important factor, a good faith evaluation [of settlement of a third-party claim] requires more.").

> Furthermore, the Chavers court expressly held that its test applied to a "direct claim," 405 So.2d at 7, and, in recognizing a new tort for first-party bad faith, it did not disown the third-party bad-faith claim. Rather, it acknowledged the distinctions between first-party and third-party insurance claims. See 405 So.2d at 5. The distinctions between the two types of claims support Alabama courts' different treatment of the claims. Alabama courts do not stand alone. As explained by the Arizona Supreme Court, which also holds first-party and third-party claims to different standards and restricts the arguable-reason test to the first-party bad-faith claim, [quoting the decision cited above]. In the third-party bad-faith context, "the debatability of the claim is not determinative; the insurer must also weigh other considerations, such as the financial risk to the insured in the event of a judgment in excess of the policy limits."

(citations omitted). Judge Watkins also rejected the defendant-insurer's reliance on Schulte, recognizing that it was dicta and that the Alabama Supreme Court would not hold to that position in a case where the issue was directly presented:

> [A]lthough dictum can be persuasive and telling as to how a state court would hold, this court is not convinced that the Alabama Supreme Court would find Schulte's dictum convincing. The dictum is unaccompanied by any analysis. And, although it leans upon a string cite of two decisions for support, those two decisions were analyzing first-party bad-faith claims, not third-party bad-faith claims. Adoption of the standard [the defendant] draws from the Schulte dictum would require the Alabama Supreme Court to turn a blind eye to more than fifty years of precedent, where not once has the court incorporated the arguable-reason test as an element of a third-party bad-faith claim. Because the dictum in Schulte upon which [the defendant] relies contradicts Waters' totality-of-circumstances approach, it is deemed a non-binding, stray remark.

In conclusion, Judge Watkins not only held that whether an insurance company acted in bad faith in the exercise of its settlement authority depends upon "all the facts and circumstances," and not the "debatable reason test," he held that the facts and circumstances that are relevant to whether an insurer acted in bad faith in evaluating settlement of a third-party claim (as "culled from Waters, Cosby, and Hollis") include, but are not limited to, the following:18 (1) whether the insurer adequately investigated the facts of this case; (2) whether the insurer conducted a dishonest evaluation of the case; (3) how the insurer viewed its insured's liability; (4) whether the insurer considered the welfare of the insured; (5) whether there was an opportunity to settle the case within policy limits; (6) whether the insurer evaluated the anticipated range of a verdict, should it be adverse; (7) whether the insurer examined the financial risk to the insured in the event of an excess judgment in excess of the policy limits; (8) whether the insurer considered the strengths and weaknesses of all of the evidence from a liability and damages standpoint; (9) whether the insurer considered the history of the particular geographic area in cases of similar nature; and (10) whether the insurer considered the relative appearance, persuasiveness, and likely appeal of the claimant, the insured, and the witnesses at trial. Notably, these are the same factors recommended by Judge Bowdre and applied by Judge Guin in Carrier Express. The only ones omitted were those that pertain to the reservation of rights issue because there was no reservation of rights issue in Franklin.

VIII. The Proper Party.

As a practitioner, if you get an excess verdict against an insured, be leery of accepting an assignment of the insured's negligence and bad faith claims against the carrier as the law does not seem to support such an assignment. The case Cash v. State Farm, 125 F.Supp.2d 474 (M.D. Ala. 2000), is a first party case where the insureds suffered hurricane damage to their home. The home suffered damage at a time when the house was under contract to be sold to the plaintiffs. The insureds and the plaintiffs both made casualty claims against the insurer. The insurer denied the insured's claim on grounds that the damage was not caused by the hurricane. The insurer denied the plaintiffs' claim because their policy was not in effect at the time of the hurricane. The insureds then assigned all of their and causes of action of whatever kind and nature that they had against insurer to the plaintiffs, and the plaintiffs thereafter filed suit against the insurer asserting claims for breach of contract and first-party bad faith. Judge DeMent held that while the plaintiffs had standing to pursue the breach of contract claim (which is assignable per statute), only the insureds had standing to assert the bad faith claim:

> "[I]n the absence of statutory provision, rights of action purely personal ... are not assignable" to third parties. While Alabama law permits the assignment of contractual obligations and rights, see Ala. Code § 8-5-20 ... , the statute must be read consistently with the Alabama Supreme Court's unambiguous characterization of bad faith actions as tortious, rather than contractual in nature. Given that such tortious conduct is intentional, fraudulent, and personal, it cannot be the subject of assignment. Thus, the court finds that the [insureds'] purported assignment of their bad faith claim against [the insurer] violates public policy and is unenforceable. ... Because the [insureds] could not assign to Plaintiffs the right to sue [the insurer] for bad faith, the only remaining issue is whether the [the insureds] could assign the right to sue for breach of contract. ... It is well settled under Alabama law that "choses ex contractu ... are in consequence assignable."[24]

Although Judge DeMent did not technically make that latter holding because he lost subject matter jurisdiction because dismissal of the bad faith claim reduced the amount in controversy below $75K, his detailed analysis is grounded in bright line rules of Alabama substantive law. Plaintiffs respectfully submit that Judge DeMent's analysis will likely be followed by the Alabama Supreme Court, especially considering that Judge Lynwood Smith of the Northern District has also come to the same conclusion on a related issue.[25] An insured can assign her breach of contract claims but likely cannot assign her personal tort actions including the negligent, wanton, and bad faith failure to settle claims.

Indeed, one of the primary rationales for creating the negligent and bad faith failure to settle causes of action against a liability insurer was because the insured did not have a cause of action for breach of contract. The Waters Court was clear on this point:

> This Court has long since taken the position that under certain circumstances, for the breach of a contract there may be either an action of assumpsit or one in tort. That means that when there is a contract expressed to exercise reasonable diligence in the performance of an act, or when there is a specific contract to do an act, a failure to exercise reasonable diligence on the one hand or to do the act on the other gives rise to an action of assumpsit. But when the contract is to exercise reasonable care to perform the act, a failure to exercise such reasonable care may be redressed by either assumpsit or in tort. When the contract does not in terms require reasonable care in doing the act stipulated to be done, the law imposes a duty -- but does not imply a contract -- to exercise due care in doing the act; and, therefore, when negligence exists in doing that act an action in tort only is available because there is no express or implied contract which is breached. ... In the instant case there is no express contract to exercise reasonable care in performing the duties required of the insurer. Therefore, for negligence in the performance of those duties an action in tort only will lie, and then only if the law imposes a duty to exercise due care.[26]

Therefore, based on these well-reasoned decisions, it is anticipated that the Alabama Supreme Court will follow the lead and rationale of these well-reasoned decisions. A practitioner would not want to accept such an assignment and release the judgment debtor only to find out later that the cause of action that they received in exchange for the release is worthless and not actionable.

IX. The Possible Third Claim.

The practitioner might wonder whether there is any benefit to asserting a wanton failure to settle claim. Liability insurers may cite to Hollis for the proposition that Alabama does not recognize a

cause of action for wanton failure to settle a third party liability claim. However, the Supreme Court in Hollis did not hold as such. To the contrary, it held that "[w]e have not had occasion to determine whether a cause of action for wantonness is viable," but "[a]ssuming, without deciding, that a wantonness claim is viable, after a careful review of the record, we find no evidence to support that claim."[27] Therefore, in a case where there is substantial evidence of wantonness, the Hollis case would not be a barrier to recovery.

Moreover, any contention that a wanton failure to settle claim "is spurious and unnecessary in Alabama" because Alabama recognizes a claim for negligent and bad faith failure to settle is incorrect. The undersigned know of no other situation where a wanton act proximately resulting in damages requires proof of bad faith to give rise to a wantonness claim. It should be noted that the law prior to Waters only allowed an insured to sue his/her liability insurer for bad faith. The insurer in Waters argued that there was no need for a negligence remedy because there was a cause of action for bad faith. In rejecting that argument, the Supreme Court reasoned that "[w]e know of no other situation where a negligent act proximately resulting in damages to another requires that there must have been bad faith also in order to give rise to a cause of action."[28] The same could be said to apply to a wantonness claim for a liability insurer's failure to settle.

However, before pursuing a wanton failure to settle claim at trial, the practitioner should exercise caution. As stated above, it is clear that a plaintiff is entitled to punitive damages on a bad faith failure to settle case as long as they can satisfy the punitive damages statute. Proof of wantonness, of course, is just another way that punitive damages can be proven.[29] Moreover, it is the opinion of the undersigned that the standards for proving third party bad faith are very similar to proof of wantonness. Therefore, the practitioner that successfully proves third party bad faith and pursues a wanton failure to settle to a sufficient judgment may find his case reversed if the Alabama Supreme Court should choose to hold that the common law does not provide a wanton failure to settle claim. It appears that little more could be achieved by pursuing a wantonness claim.

X. The Conclusion.

A practitioner who has just gotten an excess verdict needs to have a thorough understanding of the torts available to the defendant/insured and often times must inform the defense lawyer as to the insured's rights. Quickly, your adversary in the trial now becomes your ally as it pertains to getting your client paid. The defendant/insured's claims for negligent and bad faith failure to settle provide the insured with a remedy that will allow him to get your client paid and recover his own damages for mental anguish and possibly punitive damages. Understanding and applying the proper legal standard for third party bad faith is critical to being successful in prosecuting the insured's claim and effectuating a recovery for both parties.

1 For an excellent discussion of the Alabama tort of negligent failure to settle, read the case State Farm v Hollis, 554 So.2d 387 (Ala. 1989).
2 73 So.2d at 531-532.
3 See also Allen's Ala. Liability Ins. Handbook, § 13.09, p.286 (2nd ed. 2008).
4 Fed. Ins. v. Travelers Cas., 843 So.2d 140, 143 (Ala. 2002).
5 173 So.2d at 592-593 (quoting Boston v. Cooper, 61 F.2d 446 (5th Cir. 1932)(applying Alabama substantive law)).
6 MetLife Auto v. Reid, 2013 WL 6844109, **7-8 (N.D. Ala.)(Smith)(citing Waters, supra; Cosby, supra).
7 860 F.Supp. at 1475, 1478 (citations omitted).
8 860 F.Supp. at 1479-80.
9 860 F.Supp. at 1483.
10 Bowdre, Enhanced Obligation of Good Faith ... , 50 Ala. L. Rev. 755 (1999).
11 At this point, Bowdre cited to Waters, 73 So.2d at 531532.
12 50 Ala. L. Rev. at 764-765.
13 50 Ala. L. Rev. at 784-784, n.166.
14 A.P.J.I. 20.45, Notes on Use; Smith, Allen's Ala. Liab. Ins. Handbook, § 13.08 (2nd ed. 2008); Orange Beach v. Scottsdale Ins., 166 F.R.D. 506, 510 (S.D. Ala. 1996), aff'd, 113 F.3d 1251 (11th Cir. 1997).
15 405 So.2d at 7.
16 373 So.2d at 106667 (Embry).
17 727 So.2d at 68.
18 50 Ala. L. Rev. at 764,787 (citations omitted) (brackets inserted).
19 970 So.2d at 297, n.2, 294.
20 Ex parte Williams, 838 So.2d 1028, 1031 (Ala. 2002).
21 970 So.2d at 296.
22 Bowen, 417 So.2d at 183 (citing to Chavers for the proposition that "[a]n insurer is liable for its refusal to pay a direct claim when there is no lawful basis for the refusal coupled with actual knowledge of that fact"); Barnes, 405 So.2d at 924 ("[t]he first tier of the test ... adopted by this Court in Chavers establishes that the tort of bad faith refusal to honor a direct claim arises when there exists (no lawful basis for the refusal coupled with actual knowledge of that fact").
23 Boudreaux v. Pettaway, 108 So.3d 486, 509 (Ala. 2012)(quoting Waters, 73 So.2d at 528; Hollis, 554 So.2d at 390-392; Turner, 541 So.2d at 472), overruled on other grounds, Gillis v. Frazier, __ So.3d __, 2014 WL 3796382 (Ala.).
24 125 F.Supp.2d at 477-478 (citations omitted).
25 MetLife, 2013 WL 6844109 at *8 (citing an abundance of Alabama authority for the proposition that claims for negligent and bad faith failure to settle a third party claim "are tort claims," which are "are personal to the insured" and "do not survive in favor of the insured's [e]state under Alabama law" if they "are not filed prior to the insured's death").
26 73 So.2d at 528-529 (citations omitted).
27 554 So.2d at 392.
28 73 So.2d at 529.
29 Ala. Code § 6 11 20(a)("[p]unitive damages may not be awarded in any civil action ... other than in a tort action where it is proven by clear and convincing evidence that the defendant consciously or deliberately engaged in oppression, fraud, wantonness, or malice with regard to the plaintiff").

Keith Belt's practice is focused in the areas of wrongful death and personal injury. He is an experienced trial lawyer who has over forty jury verdicts and settlements of one million dollars or more to his credit. His experience has earned him the AV Preeminent ranking by the national legal publication Martindale-Hubbell. He has also been selected as a top 100 trial lawyer by the American Trial Lawyers Association every year since 2007 and has been honored as one of Alabama's Super Lawyers for the years 2009-2015. He received a B.S. in Business and Administration from the University of Alabama in 1990 and Juris Doctorate from the University Of Alabama School Of Law in 1994. While at the University of Alabama School of Law, Mr. Belt received several awards for his trial advocacy work. He is licensed to practice law in the state and federal courts in Alabama, Georgia, Tennessee, Florida, New Mexico, and Colorado. He is also admitted to practice in front of the Tenth and Eleventh Circuit Courts of Appeal as well as the United States Federal Court of Claims in Washington, D.C. He is a member of the Christian Legal Society, the American Association of Justice, the Alabama Association of Justice, and the Birmingham Bar Association. He is a sustaining member of both the American and Alabama Associations of Justice.