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5 Tips To Avoid Bad Faith

Law360, New York (February 07, 2013, 1:06 PM ET) -- Insurance companies tend to make headlines when high-dollar or high-profile claims are denied. While insurance companies often have a valid reason for a determination of no coverage, a perception exists that insurance companies do not play by the rules and unfairly deny claims.

This perception is inaccurate but fueled by late night TV commercials, YouTube videos, bus signs and billboards. These advertisements portray a "greedy" insurance company that has "refused to pay" an alleged victim. The purveyor of the ad then promises to "protect" the victim against the insurance company if he or she will only "call now."

These ads are prominent because the "advocate for the injured" hopes to assert a claim for bad faith. Such advocates have an incentive to assert a bad-faith claim against the insurer as it opens the door for recovery of damages in excess of the policy limits.

Since both policyholders and their attorneys may be motivated to file a bad-faith claim against an insurance company, what can an insurance company do to ward off or insulate itself from a claim of bad faith? This article provides five recommendations for avoiding a bad-faith claim and an award of excess damages.

Be Aware of Company Policies

Many insurance companies have dissolved, merged or changed ownership over time such that it is difficult to keep track of policies the company adopted. However, company manuals and policies often dating back decades have been produced in litigation, and corporate filings are in the public domain.

Often, statements within these documents are taken out of context by a policyholder and used in discovery to lay the groundwork for bad-faith allegations. As such, companies should be prepared to put company manuals, policies and corporate statements into perspective. Indeed, such statements may be helpful in explaining the procedures followed or analysis taken with respect to a particular claim.

Deal with Mistakes

Mistakes happen in any business, and when one happens in the handling of a claim, it is important to correct the mistake as soon as it is discovered. More commonly, a perceived "mistake" is really a miscommunication.

For example, in the handling of a claim, a decision may have been made based on certain information provided by the policyholder that puts a set of procedures into motion that correctly leads to the denial of a claim. Yet, a policyholder may later provide additional information that could lead to a different coverage determination. While a policyholder may argue that it was bad faith for the insurer to proceed based on the initial set of facts alone, the insurer may have been completely justified in proceeding on this information.

For this reason, it is important that a file contain clear, dated notes with an explanation for each action taken. And, ultimately, if a change is made, this too should be documented along with a reason for the change.

Combat Accusations of Post-Litigation Bad Faith

If a claim results in litigation, a policyholder may attempt to allege a bad-faith cause of action based on conduct taken during the litigation. Generally speaking, litigation conduct is privileged and protected by law.

For example, serving discovery, taking depositions, filing a pleading or motion and zealously asserting legal positions during the litigation usually cannot serve as a basis for a bad-faith claim. Numerous courts have found that litigation conduct is regulated and remedied by procedural or ethical rules that apply to litigation or attorney conduct. Certain litigation conduct, such as filing a complaint or asserting an affirmative defense, is protected by the litigation privilege and in states, such as California, subject to special procedures under the anti-strategic lawsuit against public participation statute.

Moreover, under most circumstances, litigation communications with counsel are privileged and immune from discovery. And even if post-litigation-related conduct is ultimately subject to discovery, it may be irrelevant and inadmissible in relation to a bad-faith claim.

Remember the Genuine Dispute Doctrine

In a majority of states, an insurance company is not in bad faith if there is a genuine dispute as to coverage for the claim. Often, the ability to assert the genuine dispute doctrine is enhanced if a declaratory judgment action is pending regarding the disputed coverage issue.

Still, depending on the state, asserting the genuine dispute doctrine may not insulate the company from defending a claim if such an obligation exists. Regardless, in many instances, exploring the parameters of genuine dispute doctrine is worthwhile if a claim presents a novel or unusual coverage issue.

Obtain Outside Advice

Some claims have no clear answer. In these situations, it is useful to get an outside opinion to aid in evaluation of a claim and protect against an allegation of bad faith. Potentially problematic claims should be identified at the outset, and outside advice should be documented in the file and obtained prior to a coverage determination.

This way, the advice not only supports the response but also serves as evidence of its reasonableness. Yet, when seeking the advice of an attorney, communications with the attorney could become discoverable. States such as Delaware, Ohio and Arizona have issued opinions finding waiver of the attorney-client privilege when the advice results in denial of a claim. And, in many states, the attorney-client privilege can be waived if the attorney's advice is put at issue.

Still, even in the face of potential waiver of the attorney-client privilege, consulting an attorney prior to a coverage determination can often serve as evidence of reasonableness of a coverage determination and aid in defeating an allegation of bad faith.

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