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Why Small Businesses Need Their Traditional Remedy Against Bad Faith

Common Questions About Third-Party Bad Faith

1. What is "insurance bad faith"?

Insurance bad faith is the insurer's failure to settle a claim made by a third-party against its customer when, under all the circumstances, it could and should have done so, had it acted fairly, honestly, and with due regard for the interests of its customer. *See* Fla. Std. J. Instr. (Civ.) 404.4.

2. Why does Florida law recognize a remedy for insurance bad faith?

Florida liability insurance policies give near absolute power to the insurance companies. When a claim is made against an insurance customer, these policies require the customer to give complete control over all investigation and negotiation of the claim to the insurance company. The insurance company also has the total power to decide whether to settle the claim or risk going to court.

In exchange for this relinquishment of control, the insurer must act in good faith in its investigation, evaluation, negotiation and attempted settlement of liability claims brought against its insured. If an insurance company fails to honor its "fiduciary duty" of good faith, the customer has the right under the traditional common law to hold the insurance company accountable for the harm its bad faith caused its customer.

3. Can the insured customer just settle the claim on their own?

Not without risking losing their insurance coverage. Liability policies prohibit it.

4. Are common law bad faith claims based on a recent Florida Supreme Court decision?

No. Traditional Florida law, holding insurers accountable for bad faith handling of third-party claims, has been essentially unchanged since 1938. *Auto Mut. Indemn. Co. v. Shaw*, 184 So. 582 (Fla. 1938).

5. Why do small businesses need their traditional remedy against insurance bad faith?

Most small businesses go year after year with no major claims ever being made against them. In those years, the insurance company just keeps the premium and adds it to its bottom-line profit. However, even the most careful person or small business can, sooner or later, end up with a major claim against them by a third party.

When facing a claim with significant damages, the insurance customer may face excess liability that can expose even a successful business to bankruptcy and liquidation or cause a successful individual to lose the retirement nest egg he may have accumulated over a lifetime of work. When a small business fails, the economy suffers not only the lost value of the affected business but also the lost income to every employee of the business and the vendors and suppliers they support.

Florida's common law bad faith remedy incentivizes insurance companies to do their job and make reasonable efforts to protect their customers from personal liability. If a liability insurer fails to settle a liability claim in bad faith, it must pay the damages caused by that failure. In most cases, that means the insurer would be responsible for paying the amount of the judgment entered against its customer which exceeds the amount the insurer could have settled the case for earlier – saving the customer from financial ruin.

6. Is there any need to modify the traditional common law bad faith remedy?
Absolutely not. For the last 85 years, our bad faith laws have provided a beneficial effect of inducing prompt and fair settlement of claims instead of gambling with the assets and credit of the very customers whose premiums support the company. During all that time, there has been a robust and competitive market for general liability and auto liability insurance in Florida.

There is no justification for taking away the traditional rights small businesses have, and need, against insurance companies who commit bad faith when they are supposed to be protecting their customers. Changes being proposed benefit only liability insurance companies and put at terrible risk the customers who pay the premiums in exchange for a promise of protection from claims.

Small businesses and financially successful individuals particularly, who may have accumulated a nest egg of savings over a lifetime of work, would be especially hurt by any such changes that would put their assets and credit at risk, instead of protecting them, as insurance should.

7. What is an "excess judgment"?
An "excess judgment" is a judgment against an insured for more than the availability liability insurance. When a person is catastrophically injured, they have the right to obtain a judgment for all their damages, including earnings losses, medical expenses, and other losses. A person's claim against the individual or small business that is responsible is not limited to the amount of liability insurance purchased by the responsible business. When the value of a claim is greater than the policy limits of the at-fault party's liability insurance, it creates an excess exposure. That can become an excess judgment if the insurance company does not protect its customer by settling the claim.

8. Do insurance bad faith claims increase premiums?
No. Payments made to pay bad faith claims against liability insurers cannot be considered in their ratemaking. *See* §§ 627.0651(12) and 627.062(7), Fla. Stat.

9. What is the difference between "third-party" claims and "first-party" claims?
Third-party claims arise out of liability coverage, which protects the insurance customer from claims made by a third party. The liability insurer owes the customer fiduciary duties. Its sole job is to attempt to protect the customer from a judgment for more than the liability insurance policy limits.

First-party claims arise out of a first-party coverage (i.e., uninsured motorist benefits, property insurance on one's home or business, life insurance, health insurance, etc.). The customer is seeking to recover insurance benefits from the insurer. The relationship between the customer and insurer is adversarial in nature.

10. Does Florida common law recognize a cause of action for bad faith failure to settle a *first-party* claim?
No. The courts refused to recognize a claim for first-party bad faith because the insurer's action can never result in a judgment *against* the insured, and thus insurers do not owe their insureds a fiduciary duty to settle a first-party claim. However, there is a *statutory* duty of good faith that applies in first-party claims under section 624.155, Florida Statutes.

11. What is statutory bad faith?

In 1982, the legislature perceived the benefits that common law bad faith had brought to the handling of *third-party* claims (where the customer is the target of a claim) and passed a statute requiring insurance companies to act in good faith when handling *first-party* claims (where the customer is seeking benefits for himself). *See* § 624.155, Fla. Stat.

12. Insurers get special "safe harbors" in *first-party* claims. Should they get a safe harbor for *third-party* claims too?

Absolutely not! Since statutory bad faith was designed principally for *first-party claims*, it provides for an additional 60-day grace period for companies who have acted in bad faith. This time period runs after a Civil Remedy Notice of Insurer Violation ("CRN") is served. If the insurer unconditionally tenders the policy limits within the 60 days, it "cures" the alleged bad faith and the first-party claim is concluded.

But granting insurers "safe harbors" for *third-party claims* makes no sense. The insurance company that committed bad faith could take advantage of the extra grace period (whether its 45, 60, or 90 days) to protect *itself*, but the tender of the money does not automatically protect the insured customer. The injured claimant may not be willing to settle for the policy limits. The customer is left exposed and required to pay an entire excess judgment from their business assets or personal nest egg. Meanwhile, the insurer would be immune from any bad faith claim, even if the insurer failed to settle the liability claim in bad faith and caused the judgment to be entered against the insured.

13. Is it true that sometimes insurance companies with small policy limits must pay very large amounts in bad faith cases?

Yes, that can happen, but only if the insurance company acts in bad faith when it has a small policy limit and the claim against its customer is also very large. Those cases are the ones that an insurance company clearly needs to settle, rather than putting its customer at terrible risk.

14. Does bad faith law require an insurance company to settle every claim, regardless of merit?

Of course not. The insurer can consider the evidence showing who was at fault and the evidence concerning the amount of damages sustained. Claims that are not legitimate need not and should not be paid. Only if, under all the circumstances, a reasonable person standing in the shoes of the insurance customer would settle the claim, does the insurance company had an obligation to do so.

15. Can an insurance company be sued for negligently failing to settle a third-party claim?

No. Surprisingly, insurance companies already enjoy special protection, much more than ordinary people and small business. Unlike ordinary businesses, insurance companies can only be held responsible for failing to settle if they act in BAD FAITH. Insurance companies already have immunity for negligent failures to do their job. *See DeLaune v. Liberty Mutual Ins. Co.*, 314 So. 2d 601 (Fla. 4th DCA 1975). That is why it is so unjustified to further diminish insurance companies' responsibility for the financial harm caused to their customers when they act in bad faith. Of note, unlike Florida, 22 states do allow insurance customers to sue their liability insurer for negligent failure to settle.

16. Are claimants required to make a settlement offer?
No. An injured person could theoretically file a lawsuit against the policyholder the day after the injury. The injured person is legally entitled to a jury trial and, after a successful verdict, a judgment in their favor. They are not required to ever make any offer to resolve their case.

Sometimes, though, an injured person will offer to settle the entire claim against the small business for a dramatic discount, even down to the policy limit, in order to avoid the risk, delay, and expense of litigation. That settlement offer, made to the insurance company that controls whether to accept it, represents a tremendous opportunity for the small business whose future is at stake. Often it is, literally, a last-chance opportunity to save an entire business.

17. When claimants do offer to settle, what are the terms of their offer?
That is completely up to the claimant. For centuries, it has been the law that the person making the offer is the "master of the offer," meaning that they have the power to determine the time, place, and manner in which the offer may be accepted.

These settlement offers will usually have time limits and may require elements such as affidavits, insurance verifications, or specific terms for the release. As with any other contract offer, if these terms of the offer are met, there is an enforceable settlement agreement. If the terms are not met, that opportunity to settle may be lost, perhaps forever. The injured party will instead continue their claim against the small business, obtain a judgment for the full amount of the claim, and enforce it against the assets of the business or individual insurance customer.

18. Are insurance companies required to affirmatively initiate settlement negotiations?
Only if liability is clearly adverse to the insured and the damages are so serious that a judgment in excess of the policy limits is likely. If that is not the situation, insurance companies can sit back and wait for the injured claimant to make a settlement offer before they have an obligation to settle.

19. What if multiple claimants make a claim against the same insured?
The insurance company is supposed to try to settle all the claims first. But if that's not possible, the insurer is just supposed to act reasonably to try to minimize the insured's exposure. That does not mean the insurance company acts in bad faith just because it cannot settle all claims within the policy limits. An insurer can settle one claim to the exclusion of others so long as it is acting reasonably to protect the insured.

20. What if multiple insureds may be liable for the same loss?
The insurance company is supposed to try to settle the claim against all insureds first. But if that's not possible, the insurer may, after consultation with the insureds, settle the claims against certain insureds to the exclusion of others.

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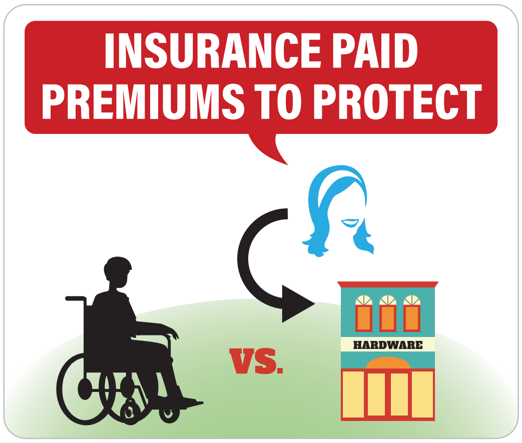
First-Party Claim

60-DAY ADDITIONAL GRACE PERIOD AFTER BAD FAITH MAKES SENSE. THERE IS NO CLAIM AGAINST THE INSURED.

Third-Party Claim



IMMUNITY AFTER BAD FAITH ONLY PROTECTS THE INSURER – NOT THE CUSTOMER!

INSURERS SHOULD NEVER HAVE SPECIAL IMMUNITIES IN THIRD-PARTY CLAIMS

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