Comparative Bad Faith

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Synopsis

The tort of bad faith allows insureds and their privities to seek the recovery of extra contractual damages. In some cases, bad faith claim handling forms the basis for the recovery of punitive damages. In recent years insurers have advanced the idea that if the insured is also guilty of misconduct, the trier of fact should be allowed to compare the errant conduct of both the insurer and insured and reduce bad faith damages assessed against the insurer on account of the insured's behavior. Although the theory of comparative bad faith is greeted with enthusiasm among many insurers, it has not been embraced by the courts. This paper examines the arguments presented by both proponents and opponents of comparative bad faith and why the courts have resolved the issue in favor of the insurance buying public.

No Jurisdiction Supports the Theory of Comparative Bad Faith.

Insurers candidly acknowledges that few courts have considered or recognized the theory of "comparative bad faith." Insurers also candidly acknowledges that the California Supreme Court has repudiated and overruled the lone case which adopted comparative bad faith. *See Kransco v. Int'l Ins. Co.*, 2 P.3d 1, 97 Cal. Rptr. 2d 151 (2000) (rejecting appeals court decisions adopting comparative bad faith). Most significantly is that insurers do not, and cannot, point to a single case from any jurisdiction which has adopted its position. There are none.

On the other hand, every jurisdiction which has considered the issue of "comparative bad faith" has rejected it. See, e.g., *Alexander Underwriters Gen. Agency, Inc. v. Lovett*, 357 S.E.2d 258 (Ga. App. 1987) (rejecting comparative fault where insured's alleged breach of covenant of good faith and fair dealing related to contractual duties and not the omission of duties giving rise to a tort"); *Nationwide Property & Cas. Ins. Co.*, 568 So. 2d 990, 990-91 (Fla. App. 1990) ("We decline to create a new affirmative defense of comparative bad faith"); *Wailua Assoc. v. Aetna Casualty and Surety Co.*, 183 F.R.D. 550, 559-60 (D. Haw. 1998) (rejecting comparative bad faith); *Johnson v. Farm Bureau Mut. Ins. Co.*, 533 N.W.2d 203 (Iowa 1995) ("We decline to adopt a tort of reverse bad faith"); *Stephens v. Safeco Ins. Co. of Am.*, 852 P.2d 565 (Mont. 1993) (rejecting comparative bad faith because insurer's breach of covenant of good faith and fair dealing is a tort claim while insured's breach is a contract claim, and noting that one cannot compare fault in tort with fault in contract); *Powers v. U.S.A.A.*, 962 P.2d 596 (Nev. 19989) ("there is no doctrine in Nevada of "comparative" bad faith between an insured and an insurer"); *First Bank of Turley v. FDIC*, 928 P.2d 298 (Okla. 1996) ("we *reject the notion* that the insured's responsibility to provide its insurer adequate notice of facts relating to insurance coverage can be translated into an actionable tort or into a contributory-fault defense concept for comparison with the fault of the insurer."); *Stumpf v. Continental Cas. Co.*, 794 P.2d 1228 (Or. App. 1990) (same); *Southland Lloyd's Ins. Co. v. Tomberlain*, 919 S.W.2d 822, 832 n.5 (Tex. App. 1996) (reasoning that defendant

"urges this court to recognize a new defense in bad faith insurance cases, which it calls 'comparative bad faith.' [The defendant] likens this defense to that of comparative negligence. It suggests no authority to support our adopting such a doctrine, and we decline to do so."); *In re Tutu Water Wells Contamination Litig.*, 78 F. Supp. 2d 436 (D.V. I. 1999). Insurers' attempts to distinguish these cases by arguing that the jurisdictions have adopted some other method for apportioning fault, but insurers never tells why the distinction makes a difference. Insurers never explain why the distinction between pure and modified comparative fault makes comparative fault a valid theory instead of a discredited theory. In fact, the distinction makes no difference. Nor have insurers explained why not a single jurisdiction accepts their theory. That's because there is good reason for the unison disapprobation of the courts.

The most important consideration is the difference between the obligations of an insurer to its insured and the obligations of an insured to the insurer. After all, the tort of bad faith arises out of the special relationship between an insurer and an insured. As the Arizona Supreme Court has noted, "For an insured, one of the implied objects of the policy is the protection, security and peace of mind that come from having purchased protection from the economic consequences of catastrophe. Thus an insurer who damages an implied object of the insurance relationship by failing to give its insured equal consideration may breach the implied covenant even though it provides the expressly promised protection. [¶] The breach of contractual covenants ordinarily sounds in contract. However, because of the special relationship between an insurer and its insured, the insured may maintain an action to recover tort damages if the insurer, by an intentional act, also breaches the implied covenant by failing to deal fairly and honestly with its insured's claim or by failing to give equal and fair consideration to the insured's interests." *Rawlings v. Apodaca*, 151 Ariz. 149, 163, 726 P.2d 565, 579 (1986).

These special factors, security and peace of mind, are not a two way street because the insured never promises those things. Thus, the remedy for the insurer's breach is not the same as the remedy for an insured's breach. An insurer's breach of the covenant sounds in tort, while the insured's breach sound's in contract. *Kransco*, 2 P.3d at 9, 97 Cal. Rptr. at 160. The California Supreme Court noted that anomaly of applying comparative fault principles between a tort and a contract action and called it comparing "apples and oranges." *Id.* at 11, 97 Cal. Rptr. at 162.

Affirmative Defense

Insurers' fallback argument is that comparative bad faith is not a tort remedy but rather is an affirmative defense. Actually, the unsuccessful proponents of comparative bad faith have argued both for a tort of reverse bad faith (i.e., an insurer seeks relief for the insured's breach of covenant) and for the affirmative defense of comparative bad faith (reducing damages by comparing fault). By whatever name or conceptual category, every jurisdiction to have considered the matter as an affirmative defense also has repudiated the concept. *E.g.*, *Alexander Underwriters General Agency, Inc. v. Lovett*, 357 S.E.2d 258 (Ga. App. 1987) (rejecting comparative fault where insured's alleged breach of covenant of good faith and fair dealing related to contractual duties and not the omission of duties giving rise to a tort"); *Nationwide Property & Cas. Ins. Co.*, 568 So. 2d 990, 991 (Fla. App. 1990) ("We decline to create a new affirmative defense of comparative bad faith"); *Wailua Assoc. v. Aetna Casualty and Surety Co.*, 183 F.R.D. 550, 559-60 (D. Haw. 1998); *Johnson v. Farm Bureau Mut. Ins. Co.*, 533 N.W.2d 203 (Iowa 1995) ("We decline to adopt a tort of reverse bad faith"); *First Bank of Turley v. FDIC*, 928 P.2d 298 (Okla. 1996); *Southland Lloyd's Ins. Co. v. Tomberlain*, 919 S.W.2d 822, 832 n.5 (Tex. App. 1996). As

the Court in *First Bank of Turley v. FDIC*, 928 P.2d 298 (Okla. 1996) observed, California initially permitted comparative bad faith as an affirmative defense, but never as a free-standing tort. *Id.* at 308. Thus, the Court in *Kransco*, 2 P.3d 1, 97 Cal. Rptr. 2d 151 (2000) rejected comparative bad faith as an affirmative defense, and thereby expressly rejected the argument insurers advances here. *Id.* at 11-13 (discussing affirmative defense of comparative bad faith and listing jurisdictions that have rejected it).

Insurers are wrong when they argue that courts have rejected only the free-standing tort of bad faith brought by an insurer. All jurisdictions have to considered the matter have rejected comparative bad faith as an affirmative defense, as a free-standing tort, or both.

All Jurisdictions Reject Comparative Bad Faith Because An Insurers' Obligations and An Insured's Obligations Under and Insurance Contract Are Very Different.

Although the duty of good faith and fair dealing, implied in all contracts, is a two-way street, the remedies for breach of that covenant are very different. "[T]he scope of the insured's duty of good faith and fair dealing, and the remedies available to the insurer for a breach of that duty, are fundamentally and conceptually distinct from the insurer's reciprocal duty, and the remedies available to the insured for breach of that duty, under the insurance policy." *Id.* at 9, 97 Cal Rptr. 2d 160. In Arizona, the *tort* of bad faith arises out of the implied covenant, but exists independent of all contract claims. *Lloyd v. State Farm Mut. Auto. Ins. Co.*, 189 Ariz. 369, 377, 943 P.2d 729, 737 (App. 1996) ("It has consistently been held that an insurer can be held liable for bad faith even when it does not violate any express provision of the insurance contract", *citing* *Taylor v. State Farm*, 185 Ariz. 174, 913 P.2d 1092 (1996); *Deese v. State Farm Mut. Auto. Ins. Co.*, 172 Ariz. 504, 838 P.2d 1265 (1992); and *Rawlings v. Apodaca*, 151 Ariz. 149, 726 P.2d 565 (1986)).

As the California Supreme Court observed, an insurer's breach of the covenant is a tort, but insured's breach is not a tort. This is because "[a]n insurer's tort liability is predicated upon special factors inapplicable to an insured." *Id.*; *accord* *Rawlings v. Apodaca*, 151 Ariz. 149, 161, 726 P.2d 565, 577 (1986) ("But in special contractual relationships, when one party intentionally breaches the implied covenant of good faith and fair dealing, and when contract remedies serve only to encourage such conduct, it is appropriate to permit the damaged party to maintain an action in tort and to recover tort damages. In insurance cases we believe the culpable conduct is an intentional act by which the insurer fails to provide the insured with the security and protection from calamity which is the object of the relationship."). The argument that a comparison of fault is even possible "is grounded on the faulty premise that the obligations of an insurer and insured—and thus their bad faith—are comparable. . . An insured is . . . not on an equal footing with its insurer—the relationship between insured and insurer is inherently unequal, the inequality resting on contractual asymmetry. An insurer's tort liability for breach of the covenant is thus predicated upon special policy factors inapplicable to the insured." *Kransco*, 2 P.3d at 11, 97 Cal. Rptr. at 162. The California Supreme Court noted that anomaly of applying comparative fault principles between a tort and a contract action and called it comparing "apples and oranges." *Id.*

Similarly, in Arizona comparative fault between defendants and a claimant applies to negligence claims,

not contract claims. *See* A.R.S. § 12-2505 ("The defense of contributory negligence or of assumption of risk is in all cases a question of fact and shall at all times be left to the jury. If the jury applies either defense, the claimant's action is not barred, but the full damages shall be reduced in proportion to the relative degree of the claimant's fault which is a proximate cause of the injury or death, if any. There is no right to comparative negligence in favor of any claimant who has intentionally, willfully or wantonly caused or contributed to the injury or wrongful death."). An insurer is not without remedy for an insured's bad faith conduct. An insured's misconduct may give rise to a breach of contract claim, a rescission claim, and even an intentional fraud claim. But, "an insurer may not . . . assert an insured's comparative bad faith as an affirmative defense to partially absolve itself of its own tort liability for breach of the covenant of good faith and fair dealing." *Kransco*, 2 P.3d at 15, 97 Cal. Rptr. at 165. The insurer's remedies are affirmative breach of contract claims, and here, insurers brought none of these type of claims.

Conclusion

No jurisdictions support the insurance industry's argument; it has been soundly rejected everywhere. Adopting comparative bad faith is reversible error and any Court is likely to reject the concept of comparative bad faith.