NEGLIGENT BAD FAITH? LIMITING INSURANCE BAD FAITH TO ITS ROOTS

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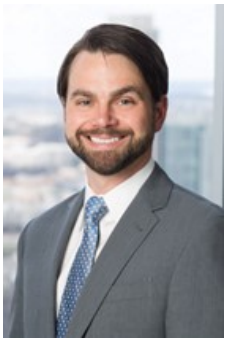

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Although frequently distinguished, an insurance policy is a contract like any other. It is a written agreement between parties that expressly sets forth the parameters of their relationship, including the consideration to be paid, the risks to be borne, and the conditions precedent to enforcement of the contract. Despite this fact, courts often wrestle with how to address perceived imbalances in bargaining power at the time the deal is struck. And while the concepts underpinning contracts of adhesion may be present, for instance, in many form automobile policies, the same cannot be said for many other liability policies, such as those obtained by Fortune 500 companies for D&O, E&O, or specialty liability coverage. Such contracts are customarily heavily negotiated. There is no inequality in bargaining power. It presumably follows then that there are circumstances under which the jurisprudence underlying follow-form auto liability policies should not apply with equal weight to other insurance contracts that are

more heavily negotiated. As discussed below, the circumstance where this disparity is most apparent is that of "bad faith" extra-contractual liability.

As a general matter, there is no tort of "bad faith" claims handling under Georgia law. O.C.G.A. Section 33-4-6 provides the exclusive remedy for claims of alleged bad faith failure to pay policy proceeds.[1] Under this statute, "an insurer is subject to imposition of a penalty and attorney fees if it refuses in bad faith to pay a covered loss 'within 60 days after a demand has been made by the holder of the policy.'"[2] For the purposes of O.C.G.A. Section 33-4-6, "a refusal to pay in bad faith means a *frivolous and unfounded denial of liability*."[3] The recovery authorized by Section 33-4-6 serves as a penalty to insurers, and as such, it is disfavored.[4]

Ordinarily, the question of good or bad faith is for the jury.[5] However, as Georgia courts have repeatedly recognized, "when there is no evidence of *unfounded* reason for nonpayment, or if the issue of liability is close, the court should disallow imposition of bad faith penalties. Good faith is determined by the reasonableness of nonpayment of a claim."[6] Because bad faith penalties are not authorized where an insurer "has any reasonable ground to contest the claim and where there is a disputed question of fact," an insurer with *any* legal or factual basis for contesting a claim should be entitled to summary judgment as a matter of law.[7]

This principle has been twice reaffirmed by the Georgia Court of Appeals in recent years. First, in *American Safety Indemnity Company v. Sto Corporation*,[8] an insurer had denied coverage under a CGL policy based on several exclusions to coverage. Unfortunately, however, the trial court found that the insurer's denials followed its accepting the defense of its insured without first adequately reserving its

rights to deny coverage.[9] Although the claims adjuster testified he had mailed the reservation of rights letter to the insured in the ordinary course, the insurer was unable to affirmatively prove having sent the letters, which the insured denied receiving. Accordingly, because of Georgia precedent regarding an insurer being estopped from denying coverage after accepting a defense without an adequate reservation of rights, the trial court determined – and the Court of Appeals agreed – that there was no basis to deny coverage as a matter of law.[10] Notwithstanding this fact, the Court of Appeals reversed the trial court on its denial of the insurer's motion for summary judgement on the statutory claim for bad faith:

> Based on the record before us, we conclude that [the insurer] was entitled to summary judgment on [its insured's] bad faith claim. The question of whether the previous reservations of rights were still effective had not been squarely answered in Georgia, and it may have appeared from a review of [the insurer's] records that reservation of rights letters had been subsequently sent out once [it] agreed to cover the litigation.[11]

In other words, alleged negligence in the mailing of the reservation of rights letters (itself sufficient to result in an estoppel) was insufficient to support an extra-contractual claim of bad faith under O.C.G.A. Section 33-4-6.

Similarly, in *Lee v. Mercury Insurance Company of Georgia,*[12] the Georgia Court of Appeals addressed a circumstance in which the insured asserted a statutory bad faith claim due to his insurer's alleged unfounded denial of his claim. In *Lee*, a divided court determined that the term "residence premises" was ambiguous as used and, thus, was construed in favor of coverage under a homeowners' policy.[13] Despite the Court of Appeals' reversal of the grant of summary judgment to the insurer on the issue of coverage, however, the court made clear that its determination of coverage was of no consequence to the issue

of statutory bad faith under the circumstances: "As we cannot say that Mercury had *no* reasonable grounds to contest Lee's claim, we affirm the trial court's grant of summary judgment to Mercury and the denial of summary judgment to Lee on the issue of Mercury's bad faith."[14] In other words, because the insurer had *some* legitimate basis to deny coverage, a claim under O.C.G.A. Section 33-4-6 would not lie.

Thus, in the context of the only bad faith claim specifically recognized by the Georgia Legislature, a *bona fide* basis for disputing coverage under the contract – regardless of whether any extra-contractual bases for a denial of coverage are also allegedly present – is sufficient to avoid a statutory bad faith claim. Under these circumstances, the terms of the parties' contract alone governs.

The same cannot be said for all insurance bad faith claims, however. In addition to the statutory bad faith claim codified in Section 33-4-6, Georgia law also recognizes a limited common law tort where an insurer fails to settle a claim against its insured for policy limits under certain, specified circumstances. The Georgia Supreme Court set forth the basic principle in *Southern General Insurance Company v. Holt*[15] as follows: "An insurance company may be liable for damages to its insured for failing to settle the claim of an injured person where the insurer is guilty of negligence, fraud, or bad faith in failing to compromise the claim."[16] The rationale behind this principle "is that the insurer may not gamble with the funds of its insured by refusing to settle within the policy limits."[17] Instead, "[i]n deciding whether to settle a claim within the policy limits, the insurance company must give equal consideration to the interests of the insured."[18] To avoid tort liability, the insurer "must accord[] the

insured the same faithful consideration it gives its own interest."[19]

Though the principle as stated by the court in *Holt* appears straightforward, the scope of conduct for which an insurer may be found liable for failing to settle within policy limits remains unclear in Georgia jurisprudence. At one end of the spectrum, there can be no reasonable dispute that an insurer can be held liable for its *bad faith* refusal to settle a claim brought against the insured for policy limits.[20] Under this standard, an insurer is liable for its "capricious refusal . . . to entertain an offer of compromise within the policy limits made on behalf of the injured party where no regard is given to the position of the insured should the case proceed to trial and a judgment in excess of the policy limits be render."[21]

What is less clear, however, is whether an insurer can be liable for mere negligence in failing to settle a claim within policy limits.[22] Some Georgia cases imply that *only* a "bad faith" refusal to settle within policy limits is actionable.[23] Others, however, suggest that a mere "negligent" failure to settle may be sufficient to impose liability on an insurer.[24] Despite the oft repeated "bad faith or negligent failure to settle" phrase, it remains the case that not a single Georgia court has actually held that mere negligence alone is sufficient to subject an insurer to extra-contractual liability.[25]

"Negligence" in the context of an insurer's failure to settle has its origin in *Francis v. Newton*.[26] In *Francis*, the Georgia Court of Appeals considered whether a garnishment action brought by a claimant against the insured's insurance carrier could proceed when the carrier had already tendered its policy limits. The court ultimately held that the claimant could not proceed with the action. In so holding, the court, relying on law from other

jurisdictions, stated that "an automobile liability insurance company may be held liable for damages to its insured for failing to adjust or compromise a claim covered by its policy of insurance, where the insurer is guilty of negligence or of fraud or bad faith in failing to adjust or compromise the claim to the injury of the insured."[27] The court specifically noted, however, that "[t]here [was] no contention by the insured that the insurer was negligent or failed to exercise good faith towards her in handling the claims of the plaintiff and his father against her, and the evidence d[id] not authorize a finding that the insurer violated any legal duty it owed to the plaintiff by failing to adjust or compromise his claim against the insured or in defending his action against the insured as it was authorized to do under the terms of its contract with the insured."[28] Thus, any discussion regarding the standard for imposing extra-contractual liability on the carrier was clearly dicta in *Francis*.

Nevertheless, the modern trend of blurring the lines between what is binding authority and what is dicta has resulted in continued citation to *Francis* for the proposition that mere negligence alone can provide a sufficient basis for imposing excess liability on the insurer. Subsequent Georgia cases, however, provide little analysis as to what type of negligence will suffice. To propound confusion over whether simple negligence is sufficient to impose extra-contractual liability on an insurer, some cases have gone so far as to blend bad faith and negligence into the same standard. Generally, bad faith and negligence are treated as "disjunctive or alternative tests."[29] But, without explanation, the Georgia Court of Appeals has held that, in this context, the difference in terminology means little.[30] Instead, the same standard is applied:

> [W]hether the basis for imposing tort liability on the insurer is phrased in terms of bad faith or negligence, an insurer may be

> liable for damages for failing to settle for the policy limits if, but only if, such ordinarily prudent insurer would consider that choosing to try the case rather than accept an offer to settle within the policy limits would be taking an unreasonable risk that the insured would be subjected to a judgment in excess of the policy limits.[31]

This type of blending is evident in the Supreme Court's decision in *Cotton States Mutual Insurance Company v. Brightman*:[32]

> An insurance company may be liable for the excess judgment entered against its insured based on the insurer's bad faith or negligent refusal to settle a personal claim within the policy limits. Judged by the standard of the ordinarily prudent insurer, the insurer is negligent in failing to settle if the ordinarily prudent insurer would consider choosing to try the case created an unreasonable risk. The rationale is that the interests of the insurer and insured diverge when a plaintiff offers to settle a claim for the limits of the insurance policy. The insured is interested in protecting itself against an excess judgment; the insurer has less incentive to settle because litigation may result in a verdict below the policy limits or a defense verdict.[33]

By blending the distinct concepts of bad faith and negligence into the same standard, it appears that Georgia courts have imputed a degree of intent into their analysis of Georgia law. In other words, by stating that an insurer acts negligently if it "*choos[es]* to try the case rather than accept an offer to settle within the policy limits," Georgia law recognizes that *a choice* must be made to take a course of action that results in rejection of an opportunity to settle within policy limits. An insurer's intent, then, must be considered. For if an insurer does not choose or intend to reject a settlement demand within policy limits – if the rejection, for example, is truly the result of a negligent failure to respond – the insurer cannot fairly be said to have chosen anything, much less acted in bad faith.

The Supreme Court's decision in *Fortner v. Grange Mutual Insurance Company*,[34] provides an illustrative example. In *Fortner*, the claimant was injured in a car accident caused by Grange's insured. The insured's business was also

insured under a policy issued by Auto Owners Insurance Company. After the accident, the claimant offered to settle all claims for $50,000 from Grange (contingent upon additional payment by Auto Owners). Grange offered to pay $50,000 contingent upon the claimant's agreement to sign a full release with indemnification language and dismiss with prejudice the suit against the insured. Given the additional terms Grange proposed, the claimant viewed this as a rejection of the policy limit demand, proceeded to trial, and received a $7 million verdict. The court held that the jury could consider the additional conditions imposed by Grange in determining whether Grange was liable for failing to settle the claim against its insured within policy limits.[35]

In *Fortner*, Grange was exposed to extra-contractual tort liability because it rejected the claimant's demand by adding conditions to the settlement. Thus, it appears that, to be held liable in tort for a bad faith refusal to settle, an insurer must make some sort of choice that amounts to an unreasonable rejection of the policy limit demand. There may be negligence in the decision-making process (e.g., failing to consider medical evidence supporting damages, or a police report evidencing clear liability), but some sort of deliberate choice is still required.

But what if, by contrast, the insurer is negligent in its efforts to *accept* the policy limit demand? Take for example, a situation where the insurance company is faced with a 30-day policy limit demand. The claims representative calendars the response deadline, but inadvertently calendars the deadline for 31 days. On the 31st day, the insurer accepts and tenders policy limits. Or, perhaps the insurer verbally accepts a $100,000 policy limits demand but inadvertently omits a zero on the settlement check, resulting in the delivery of a check for $10,000. Or, what if the insurer timely

accepts a policy limits demand, correctly drafts the check, but then sends the check to the wrong address?

These hypothetical situations cannot support a claim of bad faith, and under these facts, mere negligence should not expose the insurance company to tort liability because it is evident the insurance company did not "choos[e] to try the case rather than accept an offer to settle within the policy limits."[36] In fact, the insurance carrier made the opposite decision: It decided to tender its policy limits and eliminate the risk of excess exposure to its insured.

To assign extra-contractual liability for the insurer's alleged negligence in these scenarios would run afoul of the very purpose of the tort recognized by Georgia courts in the first instance. As mentioned above, the basis for finding the insurer liable for failing to settle a claim against its insured within policy limits is based upon the notion that the insurer should not "gamble" with the insured's funds and should give equal consideration to the insured's interest as it would its own. Imposing extra-contractual liability when the insurer has not only recognized the exposure to the insured, but also attempted to tender its policy limits cannot be squared with the courts' recognition of why an insurer may be subject to liability beyond that which it agreed to assume under contract. In these examples, the insurer has adequately considered the insured's interests and, accordingly, has tendered the policy limits. Unintended human error in effectuating the settlement should not result in excess exposure to the insurer.

Regardless of the legal theory, extra-contractual liability is, by definition, in derogation of the parties' intent as expressed in the plain language of their insurance policy. Despite efforts to distinguish it from other contracts (even those between sophisticated parties), an insurance policy is,

at bottom, a contract like any other. It sets forth the risks an insured wishes to have covered, the risks an insurer is willing to assume, and the amount of consideration necessary for an insurer to bear those risks. It is difficult to imagine another circumstance in which an alleged negligent failure to perform under a contract would subject the breaching party to *extra-contractual* liability. Why should contracts of insurance be any different?

[1] *See* Anderson v. Ga. Farm Bureau Mut. Ins. Co., 255 Ga. App. 734, 737 (2002).
[2] Jones v. State Farm Mut. Auto. Ins. Co., 228 Ga. App. 347, 350 (1997).
[3] Swyters v. Motorola Emps. Credit Union, 244 Ga. App. 356, 358 (2000) (emphasis added).
[4] Love v. Nat'l Liberty Ins. Co., 157 Ga. 259, 259 (1924).
[5] Fla. Int'l Indem. Co. v. Osgood, 233 Ga. App. 111, 115 (1998).
[6] *Id.* at 116 (emphasis added) (finding of waiver of coverage defenses did not give rise to bad faith penalties as a matter of law; the waiver did not eliminate the underlying facts and was a "close question"); Lawyers Title Ins. Co. v. Griffin, 302 Ga. App. 726, 731 (2010) ("Bad faith is shown by evidence that under the terms of the policy under which the demand is made and under the facts surrounding the response to that demand, the insurer had no good cause for resisting and delaying payment.").
[7] Amica Mut. Ins. Co. v. Sanders, 335 Ga. App. 245, 250 (2015).
[8] 342 Ga. App. 263 (2017).
[9] *Id.* at 268-70.
[10] *Id.*
[11] *Id.* at 274.
[12] 343 Ga. App. 729 (2017).
[13] *Id.* at 733-39.
[14] *Id.* at 749 (emphasis in original).
[15] 262 Ga. 267 (1992).
[16] *Id.* at 268 (citing McCall v. Allstate Ins. Co., 251 Ga. 869, 870 (1984)).
[17] *McCall*, 251 Ga. at 870 (internal quotation marks omitted).
[18] *Holt*, 262 Ga. at 268.
[19] *Id.* at 269 (internal quotation marks omitted).
[20] *See* Shaw v. Caldwell, 229 Ga. 87, 91 (1972) ("It is no longer open to question in this State that the claim of an insured under a[ ]... liability policy for damages on account of the bad faith tortious refusal of the insurer to settle a liability claim against him within the policy limits resulting in damage to him in the form of a judgment in excess of the policy limits being returned against him is a legitimate charge against the insurer upon which recovery may be had by the insured.").
[21] Cotton States Mut. Ins. Co. v. Fields, 106 Ga. App. 740, 741 (1962).
[22] *See* Delancy v. St. Paul Fire & Marine Ins. Co., 947 F.2d 1536, 1547 (11th Cir. 1991) ("Georgia law is ambiguous, however, as to whether an insured may recover for the insurer's negligent, as well as bad faith, failure to settle."); Domercant v. State Farm Fire & Cas. Co., No. 1:11-CV-02655-JOF, 2013 WL 11904718, at *1, *5 (N.D. Ga. Mar. 5, 2013) ("Georgia law has not defined precisely the contours of the action for tortious failure to settle."); Butler v. First Acceptance Ins. Co., 652 F. Supp. 2d 1264, 1275 (N.D. Ga. 2009) ("Thus, it appears that the unsettled nature of Georgia law in the tort of negligent or bad faith failure to settle persists.").
[23] *See Delancy*, 947 F.2d at 1547 (citing Jones v. S. Home Ins. Co., 135 Ga. App. 385, 388 (1975); Cotton States Mut. Ins. Co. v. Phillips, 112 Ga. App. 600, 601 (1965)).
[24] *See, e.g.*, Home Ins. Co. v. N. River Ins. Co., 192 Ga. App. 551, 556 (1989) ("While there are Georgia cases which refer to a recovery predicated on a bad faith refusal to settle and make no reference to the availability of a recovery for a negligent refusal to settle, such should not be viewed as inferring that a mere negligent refusal is inadequate to support a recovery.").
[25] Brief for Georgia Defense Lawyers Association as Amicus Curiae Supporting Appellant, *Camacho v. Nationwide Mut. Ins. Co.*, 692 F. App'x 985 (2017) (No. 16-14225) 2017 WL 2350412, at *1, *2-3.
[26] 75 Ga. App. 341 (1947).
[27] *Id.* at 343.
[28] *Id.* at 345.

[29] U.S. Fid. & Guar. Co. v. Evans, 116 Ga. App. 93, 94, *aff'd*, 223 Ga. 789 (1967).
[30] *Id.*
[31] Baker v. Huff, 323 Ga. App. 357, 363 (2013) (quotation marks and brackets omitted).
[32] 276 Ga. 683 (2003).
[33] *Id.* at 684–85.
[34] 286 Ga. 189 (2009).
[35] *Id.* at 191.
[36] *Baker*, 323 Ga. App. at 363.