20 INSURANCE BAD FAITH

Alaska has expressly recognized an insured's cause of action against an insurer for breach of the duty of good faith and fair dealing (a contractual duty implied in all insurance policies) and has held that such a claim sounds in tort.[1] In doing so, the Alaska Supreme Court accepted and adopted the reasoning of the California Supreme Court in *Gruenberg v. Aetna Insurance Co.*, 510 P.2d 1032 (Cal. 1973). The Alaska Supreme Court found that the availability of such a tort action provides a needed incentive to insurers to honor their implied covenant to their insureds, rejecting the argument that Alaska's statutory scheme regulating insurers provides sufficient incentive.

However, Alaska does not permit an injured plaintiff to bring a direct action against the third-party tortfeasor's liability insurer for failure to promptly settle a claim. In this regard, the Alaska Supreme Court concluded there is no common-law tort duty of good faith and fair dealing running from a liability insurer to an injured claimant in the absence of a contractual relationship.[2] This is consistent with the Alaska Supreme Court's refusal to permit a direct action by a claimant against the tortfeasor's liability insurer on the grounds that liability insurance is intended solely for the benefit and protection of the insured (the tortfeasor).[3]

Since the covenant of good faith and fair dealing extends to claim settlement practices (discussed in Tab 18 Unfair Claim Settlement Practices), an insurer may be held liable for bad faith if it fails to promptly, thoroughly, and fairly investigate claims and pay valid claims. The Alaska Supreme Court has held that the standards set forth in the Unfair Claims Settlement Practices Act may be used by the trial court when instructing the jury regarding the types of conduct that may be considered evidence of bad faith.[4] The court has also held that an insurance adjuster owes the insured a duty of care to fairly investigate and adjust claims. This duty is independent of any contractual obligation arising out of the insurance policy, and a breach of this duty is actionable.[5]

The elements of a cause of action for bad faith in Alaska have not been clearly articulated, but the Alaska Supreme Court has hinted that both unreasonable conduct and a bad faith intent are necessary to sustain a claim. The court has (to date) declined

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[1] *State Farm Fire and Cas. Co. v. Nicholson*, 777 P.2d 1152, 1156-57 (Alaska 1989).

[2] *O.K. Lumber Co. v. Providence Wash. Ins. Co.*, 759 P.2d 523 (Alaska 1988).

[3] *Severson v. Estate of Severson*, 627 P.2d 649 (Alaska 1981).

[4] *State Farm Mutual Automobile Insurance Co. v. Weiford*, 831 P.2d 1264 (Alaska 1992).

[5] *Continental Ins. Co. v. Bayless & Roberts*, 608 P.2d 281 (Alaska 1980).

to comprehensively define the elements of a bad faith action, but nevertheless reiterated its prior agreement with *Anderson v. Continental Insurance Co.*, 271 N.W.2d 368 (Wis. 1978), which held that:

> To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. It is apparent, then, that **the tort of bad faith is an intentional one** ....[6]

Similarly, the Alaska Supreme Court observed in *Hillman* that it has traditionally aligned Alaska with those jurisdictions which follow *Gruenberg v. Aetna Insurance Co.*, 480, 510 P.2d 1032 (Cal. 1973). *Gruenberg* characterized the tort of insurer bad faith in a manner that seemed to require **both** unreasonable conduct and bad faith. A similar double requirement was imposed in *Nobel v. National American Life Insurance Co.*, 624 P.2d 866 (Ariz. 1981), another case cited with approval by the Alaska Supreme Court in another decision involving alleged insurer bad faith.[7] In *Nicholson*, the Alaska Supreme Court confirmed that a cause of action against an insurer for breach of the duty of good faith and fair dealing sounds in tort, that statutory civil penalty provisions do not preclude awards of punitive damages against insurers, but that the evidence in the case (regarding the insurer's delay in paying a homeowner's claim) was insufficient to support an award of punitive damages.

Where an insurer can establish that no reasonable jury could regard its conduct as unreasonable, the question of bad faith need not and should not be submitted to the jury.[8]

An insurer who wrongfully denies coverage of a third-party action against the insured has materially breached the contract and may not require its insured to comply with other terms of the policy.[9] In addition, an insurer that wrongfully refuses to defend is liable for the judgment, which ensues even though the facts may ultimately demonstrate that no indemnity is due.[10] In *Sauer*, the court went on to hold that an

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[6] *Hillman v. Nationwide Mutual Fire Insurance Co.*, 855 P.2d 1321, 1324 (Alaska 1993), (*citing Anderson*, 271 N.W.2d at 376-77) (emphasis added).

[7] *State Farm Fire & Casualty Co. v. Nicholson*, 777 P.2d 1152 (Alaska 1989).

[8] *Hillman*, 855 P.2d at 1325.

[9] *Davis v. Criterion Ins. Co.*, 754 P.2d 1331 (Alaska 1988).

[10] *Sauer v. Home Indem. Co.*, 841 P.2d 176, 184 (Alaska 1992).

insurer that fails to communicate its decision to withdraw from the defense, or fails to explain the basis for such a decision, is precluded from later arguing that coverage did not exist.

In situations where the insurer is defending a claim against its insured and an adverse verdict in excess of policy limits is likely, the covenant of good faith and fair dealing places a duty on the insurer to determine the amount of a money judgment which might be rendered against its insured and to tender in settlement that portion of the projected money judgment which it contractually agreed to pay.[11] Stated a little differently, the insurer in such a situation has the duty to tender "maximum policy limits" to settle a plaintiff's demand when there is a substantial likelihood of an excess verdict against the insured.[12] If an insurer is genuinely confused as to the value of its policy limits, it should file a declaratory judgment action rather than expose its insured to personal liability.[13]

However, simply offering policy limits may not be sufficient to avoid a claim for bad faith. In *Whitney v. State Farm*, the Alaska Supreme Court held that State Farm did not breach the duty to settle by refusing an offer that demanded a settlement in excess of the available coverages. However, the court went on to state that Whitney may have other valid claims, stating:

> Whitney's complaint alleged a number of duty to settle claims outside the scope of State Farm's summary judgment motion: that State Farm failed to attempt settlement promptly, that State Farm breached the duty to settle by failing to inform Whitney of Libbey's settlement offer until it had expired, and that State Farm should have communicated other pieces of information[15] to Whitney that the insurance company did not. These claims remain open for litigation.[14]

As discussed under Tabs 6 and 18, the Alaska Supreme Court has held that an insurer has a duty to deal fairly and in good faith with its insured and that it violates this duty if it refuses unreasonably to pay a valid claim covered by the policy, if it misleads its insured regarding the insured's obligations, or if it fails to conduct a fair investigation by failing to diligently search for evidence supporting coverage.[15]

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[11] *Schultz v. Travelers Indem. Co.*, 754 P.2d 265 (Alaska 1988).

[12] *See Jackson v. American Equity Insurance Co.*, 90 P.3d 136 (Alaska 2004).

[13] *Bohna v. Hughes, Thorsness, Gantz, Powell & Brundin*, 828 P.2d 745, 768 n.58 (Alaska 1992).

[14] *Whitney v. State Farm Mut. Auto. Ins. Co.*, 258 P.3d 113 (Alaska 2011)

[15] *Great Divide Ins. Co. v. Carpenter 79 P.3d 599* (Alaska 2003).

The trial in *Jackson* resulted in a jury verdict for the liability insurer following a trial of the insured's bad faith claim. The jury found that the insurer's refusal to settle did **not** breach its duty of good faith and fair dealing. On appeal, the Alaska Supreme Court noted that the jury implicitly concluded that there was no reasonable likelihood that the insured was exposed to a judgment exceeding policy limits. The court went on to note (during its discussion of the instructions to the jury) that an insurance company can be held liable for an excess judgment where the jury concludes that there **was** a substantial likelihood of an excess judgment and the insurer failed to tender its maximum policy limits by way of settlement – regardless of whether the insurer acted maliciously or with reckless indifference to the interests or rights of its insured.

Guess & Rudd has successfully defended a good number of bad faith claims against insurance companies, including claims alleging unreasonable delay in the handling of a claim, or alleging that the insurer made only "low-ball" settlement offers, or that the insurer failed reasonably to offer full "policy limits" in the defense of a claim against its insured, or that the insurer engaged in intentional misrepresentation, fraud, unfair advertising, or discrimination.

In a case of substantial importance to insurance companies transacting business in Alaska, the Alaska Supreme Court unanimously affirmed the trial court's dismissal of all bad faith claims against Progressive Northwestern Insurance Company and its parent on the ground the insurer had a reasonable basis to dispute coverage.[16] Guess & Rudd successfully defended Progressive at both the trial and appellate levels.

In *Peter,* the insurer was presented with a claim for underinsured motorist benefits after the insured's son was struck by a motor vehicle while crossing the street. Because the question of what qualified as an "underinsured motor vehicle" was undecided at the time of the incident, the Alaska Supreme Court held that Progressive did not act in bad faith when it relied upon a reasonable interpretation of the term. In addition, Progressive had a reasonable basis to conclude that the allegedly underinsured motorist was not at fault with respect to the incident. Not only did the Supreme Court affirm dismissal of all bad faith claims, it also affirmed the dismissal of all claims alleging breach of contract, "disgorgement" and punitive damages.

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[16] *See Peter v. Progressive Corp.,* Supreme Court Op. No. 1240 (February 22, 2006).