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THE LAW OF INSURANCE COMPANY CLAIM MISCONDUCT IN WEST VIRGINIA

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PART I: FIRST PARTY COMMON LAW BAD FAITH

I. INTRODUCTION

Insurance can be classified as first party or third party. First party insurance involves only two parties: the insurance carrier and its insured. Third party insurance involves the insurance carrier, its insured, and a third party claimant. This introductory section will examine common law insurance company claim misconduct in first party insurance transactions. A claim of insurance company claim misconduct in first party insurance transactions arises when an insurance company engages in practices that harm its own insured. These practices include, but are not limited to, refusing to pay a legitimate claim, delaying a claim, undervaluing a claim, deceiving its insured, misinterpreting policy provisions, or engaging in many other types of misconduct.[1] Insurance is purchased for protection. Thus, when an insurance company engages in conduct that not only does not protect its insured, but in fact harms him, then the insurance company is liable for this misconduct.

West Virginia is unique: it is the only state that does not require proof of wrongful conduct on the part of the insurer in an insurance company misconduct claim. In *Hayseeds, Inc. v. State Farm Fire & Cas*ualty,[2] the Supreme Court of West Virginia held that an insured may recover whenever a policyholder substantially prevails against its insurer regardless of good faith or bad faith.[3] Once it has been decided that the insurer breached its contract with its insured, then the insured should not have to bear the burden of the cost of enforcing the insurer's contractual obligation.[4] An insured buys insurance for protection, not for a lawsuit with the insurer.

II. HISTORY

A. National

The first type of remedy recognized for an insurer's misconduct was a contract action. An insurance policy is a contract and is, therefore, governed by contract law. When an insurer is guilty of misconduct, it then breaches the contract and the insured can recover damages using contract theories. The key landmark case to determine the amount of damages recoverable in a breach of contract action

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1 For a more extensive list of insurance company misconduct see *infra* text accompanying note 51.

2 352 S.E.2d 73 (W. Va. 1986).

3 *Id.* at 80.

4 *Id.*

is *Hadley v. Baxendale*.[5] In this case, the English Court held that damages recoverable for a breach of contract are limited to those reasonably within the contemplation of the parties at the time the contract is entered.[6] For an insured to recover damages for breach of a contract with the insured, the damages must be foreseeable.

Contract law was inadequate to deal with an insurer's claim of misconduct. First, the bargaining power between an insurance company and an insured was unequal. "The philosophy underlying contract law presuppose[d] dealings among equals."[7] Insurance companies were powerful financial entities, and the insured, lacking such resources, relied upon his insurance carrier to fairly compensate for his loss. Second, contract actions were subject to many technical defenses.[8] Also, because of the doctrine of efficient breach, contract law was insufficient to deal with an insurer's wrongful refusal to pay first party claims. "[T]he oracles of the common law, including great and distinguished judges such as Oliver Wendell Holmes, legal scholars, and law professors . . . have, for many years, taught that it is not in-and-of-itself morally impermissible to breach a contract."[9] On the contrary, these scholars have taught that it is either morally neutral or economically efficient to breach a contract.[10] Lay-people do not follow this doctrine, because they believe that contracts are promises that are not to be broken. However, companies that are involved in finance have subscribed to this doctrine when it satisfies their purpose. After all, that is what legal scholars learned in law school.[11] Finally, contract law was insufficient because consequential damages based upon foreseeability were difficult to prove. The insured's main reason for purchasing insurance was to guard against unpredictable risks and their consequences. However, consequential damages must have been within the contemplation of the parties at the time of contracting. Thus, the main reason for obtaining insurance was the same reason that made obtaining consequential damages so difficult. In addition, punitive damages were not recoverable in contract actions, so insurance companies could engage in malicious conduct without fear of punishment.

Because contract law was inadequate to deal with insurer misconduct, the tort of bad faith was developed.[12] It was first recognized in third party insurance.[13]

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5 9 Exch. 341, 156 Eng. Rep. 145 (1854).

6 *Id.*

7 *Common Law Insurer Bad Faith: Purpose, Promise, and Problems*, INS. LITIGATION RPTR., Aug. 15, 1997, at 487.

8 *Id.*

9 *Id.* at 488.

10 *Id.*

11 *Id.*

12 *Common Law Insurer Bad Faith: Purpose, Promise, and Problems*, INS. LITIGATION RPTR., Aug. 15, 1997, at 487.

The tort of bad faith for breach of an insurer's obligation in the area of first party insurance was first recognized in 1973 in *Gruenberg v. Aetna Insurance Co.*[14] In *Gruenberg*, the California Supreme Court held that the insurer's duties to act in good faith in handling the claims of third parties against the insured and the claims of its own insured were merely two facets of the same duty:[15]

> That responsibility is not the requirement mandated by the terms of the policy itself - to defend, settle, or pay. It is the obligation, deemed to be imposed by law, under which the insurer must act fairly and in good faith in discharging its contractual responsibilities. Where in so doing, it fails to deal fairly and in good faith with its insured by refusing, without proper cause, to compensate its insured for a loss covered by the policy, such conduct may give rise to a cause of action in tort for breach of an implied covenant of good faith and fair dealing.[16]

The court extended the tort of bad faith already recognized in third party claims to first party claims. The tort of bad faith has four elements: "(1) the insurer's duty of good faith and fair dealing, (2) breach of that duty through (3) bad faith conduct by the insurer, i.e., 'the absence of a reasonable basis for denying benefits of the policy and the [insurer's] knowledge or reckless disregard of the lack of a reasonable basis for denying the claim,'[17] and (4) damages resulting from the insurer's bad faith conduct."[18] The main aspect of a claim for insurance company misconduct is unreasonableness in processing insurance claims.

B. West Virginia History

1. Contract

West Virginia also recognized that contract law was inadequate to deal with insurance company misconduct. Not only is there unequal bargaining power between the insured and his insurance company, but West Virginia courts also limit the amount of damages recoverable in contract actions to the policy benefits plus

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13 Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

14 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

15 *Id.* at 575.

16 *Id.* at 573-74.

17 Anderson v. Continental Ins. Co., 271 N.W.2d 368, 376 (1978).

18 Linda Gay, *Tort of Insurer's Bad Faith Refusal to Pay First-Party Claims*, 82 W. VA. L. REV. 579, 596 (1980).

interest.[19] However, more recently, West Virginia courts have extended damages recoverable in contract actions to include compensatory damages incurred as a result of the insurer's breach of its contractual duty.[20] These damages are limited to those that

> may fairly and reasonably be considered as arising naturally — that is, according to the usual course of things — from the breach of the contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of its breach.[21]

As mentioned earlier, these damages are difficult to prove. An action under contract law also does not allow the insured to recover damages for mental suffering or punitive damages in West Virginia.[22]

2. Extra-Contractual Liability

The first mention of insurance company claim misconduct in the first party context was in 1977 in Justice Neely's prescient concurrence in *Jarrett v. E.L. Harper & Son, Inc.*[23] In *Jarrett*, even though the court held that annoyance and inconvenience were proper elements of damages in property damage cases, Justice Neely went even further.[24] In his concurrence, he referred to the ability of people with property damage to sue for inconvenience and annoyance as "an act of divine justice."[25] He realized that the many complex issues involved in insurance disputes must ultimately be worked out on a case by case basis, developing a new body of law which he hoped would make dealings among people far more equitable.[26] This statement by Justice Neely, in effect, predicted the development of the tort of insurance company claim misconduct in first party insurance.

Writing in the 1980 West Virginia Law Review, Linda Gay proposed that the tort of insurance company claim misconduct applies to first party insurance.[27] She stated that an insured's economic and emotional well-being is severely

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19 Rubenstein v. Metropolitan Life Ins. Co., 118 W. Va. 367, 190 S.E. 531 (1937).

20 Kentucky Fried Chicken of Morgantown, Inc. v. Sellaro, 214 S.E.2d 823, 827 (W. Va. 1975) (citing 22 AM. JUR. 2D *Damages* § 56 (1965)).

21 *Id.*

22 *See generally* Short v. Grange Mut. Casualty Co., 307 F. Supp. 768 (S.D. W. Va. 1969).

23 235 S.E.2d 362 (W. Va. 1977).

24 *Id.* at 366.

25 *Id.*

26 *Id.*

27 *See generally* Gay, *supra* note 18.

endangered when his insurer wrongfully denies or delays payment of a valid claim.[28] She described how inadequate the existing judicial, statutory, and contractual remedies were to compensate the wronged insured.[29] She argued how the recognition of the tort of insurance company claim misconduct would "destroy the climate in which such wrongdoing [insurance company denying its insureds policy benefits and forcing the insured to go to court and pay high fees] may now flourish."[30] The Supreme Court in West Virginia took Linda Gay's recommendations to heart.

In 1986, the West Virginia Supreme Court first recognized insurance company misconduct in first party insurance claims in *Hayseeds, Inc. v. State Farm Fire & Cas.*,[31] a typical arson case where the failing company caught on fire in the middle of the night. When the insureds filed their claim for property damage with the insurance company, the insurer declined to pay on the grounds of arson.[32] In deciding this case, the Court did not use good faith and fair dealing as the standard for insurance company conduct. The standard used was more strict. The Court stated that "whether an insurer's refusal to defend was in good or bad faith is largely irrelevant once it has been established that the insurer breached its contract with its insured . . . . In either case, the insured is out his consequential damages and attorney's fees."[33] The Court established a strict liability standard in which the insurer is liable for reasonable attorney fees and consequential damages if the insured substantially prevails. The concepts of "reasonable, unreasonable, wrongful, good faith and bad faith" have no bearing on this determination.[34]

III. NATIONAL LAW NORMS

In 1973 the landmark case of *Gruenberg* was decided in California.[35] There, the California Supreme Court created a contract good faith and fair dealing as the standard for insurance company claim misconduct.[36] Since the *Gruenberg* decision, at least twenty-four states have adopted some type of tort for insurance company claim misconduct. These states include Alabama, Alaska, Arizona, Arkansas, Colorado, Connecticut, Idaho, Indiana, Iowa, Kentucky, Mississippi,

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28 *Id.* at 609.

29 *Id.*

30 *Id.* at 610.

31 352 S.E.2d 73 (W. Va. 1986).

32 *Id.*

33 *Id.* at 79.

34 *Id.* at 80.

35 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

36 *Id.* at 575.

Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Texas, Wisconsin, and Wyoming.[37] Additionally, the highest courts of New Hampshire, Utah, and West Virginia have recognized the right to recover extra-contractual damages using expanded versions for damages under breach of contract.[38] Two other states, Florida and Pennsylvania, have enacted statutes that create causes of actions against insurers for acts constituting bad faith.[39] With the exception of West Virginia, all of these thirty states require proof of wrongful conduct in order for the insured to obtain damages in excess of the policy benefits.[40] These jurisdictions, however, vary on what type of wrongful conduct is considered "misconduct."[41]

The prototypical situation of insurance company misconduct involves the refusal of an insurer to pay a claim despite its knowledge that there was no reasonable basis for denying it. This type of situation fits the definition of an intentional tort because the insurer knows it is causing harm to its insured by not paying a legitimate claim. The test for insurance company claim misconduct, however, is not limited to this situation because insurance companies rarely intend to harm their insured.[42] This test includes a broader standard of culpability, which varies in each jurisdiction.

In 1978, the most famous case that defined insurance company claim misconduct was *Anderson v. Continental Insurance Co.*.[43] *Anderson* extended insurance company claim misconduct to include not only situations where an insurer knew it had no legitimate basis for denying a claim, but also to situations where an insurer "recklessly" disregarded the rights of its claimant.[44] "Even though an insurer does not actually know that it has no legitimate basis for denying a claim, the insurer may still be liable if there is a high probability that it did not have a reasonable basis and the insurer is either: (1) aware of this fact or (2) has information that would put a reasonable insurer on notice of this fact."[45] Of the thirty states that recognize insurance company claim misconduct, at least ten appear to follow the test set out in *Anderson*.[46] Also, two other jurisdictions have expanded

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37 Roger C. Henderson, *The Tort of Bad Faith in First Party Insurance Transaction After Two Decades*, 37 ARIZ. L. REV. 1153, 1153-54 (1995).

38 *Id.* at 1155.

39 *Id.*

40 *Id.* at 1156.

41 *Id.*

42 *Id.* at 1157.

43 271 N.W.2d 368 (Wis. 1978).

44 *Id.* at 376-77.

45 *See* Henderson, supra note 37, at 1157.

46 *Id.* at 1158. The states that follow this test are Alabama, Alaska, Arizona, Colorado, Kentucky,

the basis of culpability to include "gross negligence,"[47] and maybe as many as three jurisdictions have extended the tort to include mere negligent conduct.[48] Finally, one state holds that an insurer may be liable without regard to fault when the insured substantially prevails.[49]

The normal fact situation in which insurance companies are held liable for claim misconduct in first party insurance involves the refusal to pay or delay in paying the policy benefits.[50] Insurance companies are also liable for this tort in many other situations:

> Courts have recognized that an insurer is subject to liability for attempting to deceive an insured, misinterpreting records or policy provisions for the purpose of defeating coverage, using undue threats to force an insured to agree to an unfair settlement, falsely accusing an insured of wrongdoing, exploiting an insured's vulnerable position, making oppressive demands not required under the policy, conditioning payment of an undisputed portion of a claim on settlement of a disputed portion, unfairly imposing a premium increase in retaliation for filing a claim, destroying evidence that would support the insured's claim for benefits, relying on evidence that would be inadmissible at trial, wrongfully refusing to defend its insured against a liability claim by a third party, and refusing to pay a third-party tort claimant who has obtained a final judgment against its insured.[51]

There are other instances not involving a claim for policy benefits where an insurer is liable for claim misconduct. These instances are not as common, and they all illustrate that "the insurer's duty of good faith and fair dealing is not limited to a violation of specific policy provisions."[52] These include situations when an insurer wrongfully fails to renew policies of insurance even though there were no express obligations to do so under the contract,[53] when an insurer abuses it

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Nebraska, Rhode Island, South Dakota, Wisconsin, and Wyoming.

47 *See id.*; Aetna Casualty & Sur. Co. v. Day, 487 So. 2d 830, 832 (Miss. 1986); Jessen v. National Excess Ins. Co., 776 P.2d 1244, 1247 (N.M. 1989).

48 *See* Henderson, *supra* note 37, at 1158; Zoppo v. Homestead Ins. Co., 644 N.E.2d 397 (Ohio 1994); Nichols v. State Farm Mut. Auto Ins. Co., 306 S.E.2d 616, 620 (S.C. 1983); Aranda v. Insurance Co. of N. Am., 748 S.W.2d 210 (Tex. 1988).

49 Hayseeds, Inc. v. State Farm Fire & Casualty, 352 S.E.2d 73, 80 (W. Va. 1986).

50 Henderson, *supra* note 37, at 1159.

51 *Id.* at 1159-60.

52 *Id.* at 1160-61.

53 Ballow v. PHICO Ins. Co., 875 P.2d 1354, 1362-64 (Colo. 1993).

subrogation rights,[54] when an insurer issues retrospective premium policies,[55] and when an insurer does not provide the insured a copy of an investigation report regarding a claim for a fire loss.[56]

Additionally, even less common fact situations give rise to a cause of action for insurance company claim misconduct. Two in particular warrant attention because of their effect of expanding this tort. The first of these involves the duty of an insurer to inform its insured of rights under a policy. The second kind of case deals with insurers who engage in fraudulent conduct "to actively mislead the insured with regard to a claim that the insurer was processing."[57] In this area the insurer is liable for claim misconduct for engaging in wrongful claim process.[58] Cases in these two areas are rare, but their existence may cause other jurisdictions to follow this lead and expand the tort of insurance company claim misconduct.

IV. WEST VIRGINIA OVERVIEW

The following section will discuss in chronological order the cases in West Virginia on insurance company misconduct in the first party context.

A. Hayseeds, Inc. v. State Farm Fire & Cas.[59]

In this fire insurance case, the plaintiff, the insured, sued the defendant, the insurer, for policy proceeds and extra contractual damages.[60] The insurer denied payment on the grounds of arson.[61] The court found that bad faith has no place in the law of property damage insurance cases.[62] It determined that when the insured substantially prevails in a suit against an insurer, then the insured is entitled to attorney fees and consequential damages.[63] The insured may also obtain an award of punitive damages if he can prove "actual malice."[64]

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54 Brunet v. American Ins. Co., 660 F. Supp. 843 (D. Vt. 1987).

55 Security Officers Serv., Inc. v. State Compensation Fund, 21 Cal. Rptr. 2d 653 (Ct. App. 1993).

56 Rawlings v. Apodaca, 726 P.2d 565 (Ariz. 1986).

57 Henderson, *supra* note 37, at 1163.

58 *Id.* at 1164.

59 177 W. Va. 323, 352 S.E.2d 73 (1986)

60 *Id.* at 75.

61 *Id.*

62 *Id.* at 80.

63 *Id.* at 81.

64 *Hayseeds*, 352 S.E.2d at 80-81.

B. *Berry v. Nationwide Mut. Fire Ins. Co.*[65]

In this property insurance case, the insured's house was damaged by blasting, and the insured sued the blaster and the insured's homeowner's insurer in one action. Both of the defendants denied the insured's claim.[66] A pretrial conference resulted in a settlement with the blaster, which was credited toward the insured's compensatory damage award at trial.[67] The court found: (1) The insurer's denial of the insured's claim foreclosed its subrogation claim and was not an accord and satisfaction;[68] (2) Bifurcation is not required, but it is permissive and discretional on the part of the trial court under Rule 42(c);[69] (3) Breach of good faith and punitive damages are proper;[70] (4) Amending the *ad damnum* clause to conform to the verdict is proper;[71] and (5) Prejudgment interest on policy proceeds is proper, and prejudgment interest on insurance company claim misconduct damages is not proper.[72] The case was tried ten months prior to *Hayseeds*, but the Circuit Court's instructions were in accordance with the principles in *Hayseeds*.[73]

C. *Weese v. Nationwide Ins. Co.*[74]

Insureds brought action in federal court against an uninsured motorist carrier for breach of contract, tortuous bad faith, and unfair trade practices.[75] The Court found that the insurer owed the insured a contractual duty of good faith and fair dealing, and was subject to the West Virginia Unfair Trade Practices Act.[76] It determined, however, that there was no cause of action in tort for bad faith in first party insurance, only in third party insurance.[77]

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65 181 W. Va. 168, 381 S.E.2d 367 (1989)

66 *Id.* at 370.

67 *Id.*

68 *Id.* at 372.

69 *Id.* at 373.

70 *Berry*, 382 S.E.2d at 373.

71 *Id.* at 376.

72 *Id.* at 377.

73 *Id.* at 375.

74 879 F.2d 115 (4th Cir. 1989).

75 *Id.* at 116.

76 *Id.* at 117.

77 *Id.* at 120.

D. Thomas v. State Farm Mut. Auto Ins. Co.[78]

This case involved an automobile accident in which the insurer delayed in settling the claim and undervalued the claim. The damages were approximately equal to the amount sought by the insured.[79] The trial court found that the insured had substantially prevailed, and it awarded him attorney's fees.[80] The Court held: (1) the substantally prevailed standard from *Hayseeds* also applies when the insurer makes a low (not just no) offer;[81] (2) the insured is under no obligation to accept an unreasonable settlement offer (not mitigation of damages);[82] and (3) whether an insured substantially prevails is determined at the time the negotiations break down.[83] "Where the insurance company has offered an amount materially below the damage estimates submitted by the insured, and the jury awards the insured an amount approximating the insured's damage estimates, the insured has substantially prevailed."[84]

E. Jordan v. National Grange Mut. Ins. Co.[85]

The insured's business was destroyed by a fire, and a settlement with the insurer was reached for the full policy proceeds. A dispute arose as to the amount of attorney's fee because the settlement was silent on this matter. The court found that the substantially prevailed standard does not require a jury verdict.[86] To recover attorney's fees, the insured must show that "but for his or her attorney's services such settlement would not have been reached."[87] The amount of attorney's fees is determined by the twelve factors in *Pitrolo*.[88]

F. Firstbank Shinnston v. West Virginia Insurance Co.[89]

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78 181 W. Va. 604, 383 S.E.2d 786 (1989).

79 *Id.*

80 *Id.*

81 *Id.* at 789.

82 *Id.* at 790.

83 *Thomas*, 383 S.E.2d at 790.

84 *Id.* at 790-91.

85 183 W. Va. 9, 393 S.E.2d 647 (1990).

86 *Id.* at 652.

87 *Id.*

88 *Id.*

89 185 W. Va. 754, 408 S.E.2d 777 (1991).

The lender under a deed of trust brought an action against a fire insurer to recover policy proceeds and *Hayseeds* damages as a loss payee under the policy's standard mortgage clause.[90] In this case, the Court considered the lender an insured[91] who was entitled to attorney's fees and costs under the principles stated in *Hayseeds*.[92]

G. *D'Annunzio v. Security-Connecticut Life*[93]

This was an action to determine the plaintiff's rights under a life insurance policy. The plaintiffs were claiming that the principle of *Hayseeds* applied to life insurance. The defendant insurance company argued that *Hayseeds* was fact bound to property damage cases only. The court agreed with the plaintiff and extended *Hayseeds* to life insurance.[94]

H. *Smithson v. United States. Fidelity & Guaranty Co.*[95]

The insured made a claim for the value of his insured truck after it was destroyed in a gas well explosion. The insured and insurer could not agree as to the value of the property, so it was submitted to appraisal.[96] The insured sued the insurer, alleging that it acted in bad faith by failing to settle his claim promptly.[97] The court found that the *Hayseeds* substantially prevailed standard also applies to appraisal proceedings.[98]

I. *Arndt v. Burdette*[99]

This case involved a consent-to-settle provision pertaining to the underinsured motorists coverage of an automobile insurance policy. The insured settled with the tortfeasor with the insurer's written consent to settle.[100] The court stated that "if an insurer acts unreasonably in refusing to give written consent to

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90 *Id.* at 777.

91 *Id.* at 784.

92 *Id.* at 785.

93 186 W. Va. 39, 410 S.E.2d 275 (1991)

94 *Id.* at 279.

95 186 W. Va. 195, 411 S.E.2d 850 (1991).

96 *Id.* at 853.

97 *Id.*

98 *Id.* at 858.

99 189 W. Va. 722, 434 S.E2d 394 (1993).

100 *Id.* at 397.

settle, that insurer may be subjecting itself to a bad faith claim."[101] However, in this case, the Court determined that the insurer did not act unreasonably.[102]

J. Marshall v. Saseen[103]

The plaintiffs sued their own insurance company for bad faith failure to settle their underinsured claim. The insurance company argued that there was no such thing as first party bad faith. The Court found that (1) underinsured motorist coverage constitutes first party insurance;[104] (2) *Hayseeds* applies to all first party insurance;[105] and (3) *Hayseeds* applies to underinsured motorist coverage.[106]

K. Morrison v. Haynes[107]

The administrator of the insured's estate brought an action to recover uninsured motorist benefits. The Court found that an uninsured or underinsured motorist carrier who acts in bad faith is a joint tortfeasor and is entitled to setoff other payments, so that its liability for a verdict in excess of policy limits is reduced by the amount of other uninsured benefits paid on behalf of the tortfeasor.[108]

L. Hadorn v. Shea[109]

This case involved an underinsured motorist claim in which the insured demanded $300,000. The insurer offered $22,500, and the jury awarded $90,000.[110] The court held that the insured did not substantially prevail. It did not base the decision on a purely mathematical calculation.[111] Instead, it "considered the status of the claim at the time negotiations broke down, which included consideration of the insured's interest in attempting to settle before trial."[112] The "insured must

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101 *Id.* at 400 n.10.

102 *Id.*

103 192 W. Va. 94, 450 S.E.2d 791 (1994).

104 *Id.* at 797.

105 *Id.*

106 *Id.*

107 192 W. Va. 303, 452 S.E.2d 394 (1994).

108 *Id.*

109 193 W. Va. 350, 456 S.E.2d 194 (1995).

110 *Id.* at 196.

111 *Id.* at 198.

112 *Id.*

show that but for his or her attorney's services such settlement would not have been reached."[113]

M. Jones v. Westbanco Bank Parkersburg[114]

The mortgagee on the homeowner's insurance policy wanted a determination that it suffered a loss as of the date of the fire, even though the mortgagors continued to make monthly payments on the debt.[115] The Court held that the mortgagee is a full-fledged insured who is entitled to be paid at the time of the loss.[116] Failure to pay the mortgagee at the time of the loss obligated the insurer to pay *Hayseeds* damages.[117]

N. Burgess v. Porterfield[118]

The insurer brought a suit against an uninsured motorist and an establishment that served alcoholic beverages to that motorist. The insurer offered $50,000, which was one-half of the policy limit. The jury awarded $136,000.[119] The Court determined that the insured substantially prevailed.[120] The Court also held that when compensatory and punitive damages are awarded, the defendant is entitled to a reduction by the amount of good faith compensatory settlements previously made with the plaintiff by other jointly liable parties.[121]

O. State ex rel. State Farm Mut. Auto Ins. Co. v. Canaday[122]

The uninsured motorist carrier wanted to appear in its own name instead of in the name of the uninsured tortfeasor. The court determined that the uninsured carrier could appear in its own name rather than that of the uninsured tortfeasor.[123] It also held that an uninsured motorist carrier owes its insured an obligation of good

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113 *Id.*

114 194 W. Va. 381, 460 S.E.2d 627 (1995).

115 *Id.* at 627.

116 *Id.* at 634.

117 *Id.* at 635-36.

118 196 W. Va. 178, 469 S.E.2d 114 (1996).

119 *Id.* at 117.

120 *Id.* at 123.

121 *Id.* at 121.

122 197 W. Va. 107, 475 S.E.2d 107 (1996).

123 *Id.* at 110.

faith and fair dealing.[124]

P. McCormick v. Allstate Insurance Co.[125]

The insured brought an action against his car insurer to recover compensatory damages, attorney's fees, and punitive damages for the insurer's low settlement offer for the loss of the car. To determine that the insured had not substantially prevailed and was not entitled to *Hayseeds* damages, the court compared the jury verdict of $995 to the insured's demand of various amounts ranging from $250,000 to $250,000,000.[126]

Q. Landmark Baptist Church v. Brotherhood Mutual Insurance Co.[127]

The insured brought an action against his property insurer that had refused to pay a claim for property damage. In determining whether the award of attorney's fees was reasonable and proper, the Court found that the twelve factors in *Pitrolo* are to be used to determine whether attorney's fees are proper.[128] It found that when the insured submits the fee arrangement between his attorney and detailed descriptions of the services performed, then the trial court has sufficient information to determine the reasonableness of the attorney's fees.[129]

R. Miller v. Fluharty[130]

An insured sued his insurance carrier to recover attorney's fees, costs, and prejudgment interest because it would not pay the policy limits of the underinsured's motorist policy. In determining that the insured substantially prevailed, the Court modified the standard. It stated that the "totality of the policyholder's negotiations with the insurance carrier, not merely the status of negotiations before and after a lawsuit is filed," is used to determine whether a policyholder has substantially prevailed.[131] The insured did not recover prejudgment interest on the award of attorney's fees and costs because these amounts were not "ascertainable, pecuniary, out-of-pocket expenditures to the plaintiff that support

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124 *Id.* at 115.

125 197 W. Va. 415, 475 S.E.2d 507 (1996).

126 *Id.* at 516.

127 199 W. Va. 312, 484 S.E.2d 195 (1997).

128 *Id.* at 198.

129 *Id.* at 198-99.

130 201 W. Va. 685, 500 S.E.2d 310 (1997).

131 *Id.* at 321.

an award of prejudgment interest."[132]

V. WEST VIRGINIA CAUSE OF ACTION

Four sequential steps are needed to prove a first party common law cause of action for insurance claim misconduct in West Virginia: (1) the underlying claim must have been ultimately resolved; (2) the insured must have substantially prevailed; (3) the insurer must have acted in bad faith; and (4) the insurer must have acted with actual malice. This section outlines each of these steps.

A. The Underlying Claim Must Have Been Ultimately Resolved

The first sequential step is that the insured must prevail in his policy claim. All that the plaintiff / insured must do is prove the legitimacy of his policy claim. For example, the insurer may outright deny the claim as in *Hayseeds*,[133] may lowball as in *Thomas*,[134] or may delay as in *Miller*.[135] In *Hayseeds*, the insurance company claimed arson and declined to pay policy proceeds for a fire.[136] The plaintiff was forced to sue the insurer and won at trial. In other words, the plaintiff prevailed. When the plaintiff prevails, he is entitled to policy proceeds.[137]

B. The Insured Must Have Substantially Prevailed

The second sequential step is to substantially prevail. West Virginia is the only state that has established the unique rule of "substantially prevailed" in first party insurance company claim misconduct cases.[138] The substantially prevailed rule originated in *Hayseeds, Inc. v. State Farm Fire & Cas.*[139] The substantially prevailed standard was adopted to induce insurance companies to settle claims fairly and promptly.[140] Under this standard, if the insured is forced to sue his insurer, then he is entitled to a low threshold of damages.[141] This will promote

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132 *Id.* at 325.

133 Hayseeds, Inc. v. State Farm Fire & Cas., 352 S.E.2d 73 (W. Va. 1986).

134 Thomas v. State Farm Mut. Auto Ins. Co., 383 S.E.2d 786 (W. Va. 1989).

135 Miller v. Fluharty, 500 S.E.2d 310 (W. Va. 1997).

136 *Hayseeds*, 352 S.E.2d at 75.

137 W. VA. CODE § 56-6-31 (1997); *Miller*, 500 S.E.2d at 325-26 (holding prejudgment interest not recoverable on attorney's fees and costs because these expenses are not ascertainable, pecuniary, or out-of-pocket); Berry v. Nationwide Mut. Fire Ins. Co., 381 S.E.2d 367, 377 (W. Va. 1989).

138 Henderson, *supra* note 37, at 1155.

139 352 S.E.2d at 80.

140 *Id.* at 79.

141 *Id.* at 80.

prompt, fair, and equitable settlements. The substantially prevailed rule provides that whenever a policyholder must sue his own insurance company over any property damage claim, and the policyholder substantially prevails in the action, the company is liable for the payment of the policyholder's reasonable attorneys' fees, damages for net economic loss caused by the delay in settlement, as well as an award for aggravation and inconvenience.[142] West Virginia automatically awards policyholders these types of damages when the policyholder substantially prevails.[143] Thus, when an insurer denies policy claims in West Virginia, it does so at its own peril. No proof of wrongful conduct is required, only proof that the policyholder substantially prevailed. This results in strict liability for insurance companies who deny, lowball, or delay claims.

1. How does a court determine whether an insured substantially prevailed?

This is a most difficult question. West Virginia has not established a bright line rule to determine whether an insured substantially prevails. Instead, the court has enunciated a vague standard that has led to much uncertainty.[144] The substantially prevailed standard is illustrated by four cases: *Hayseeds*,[145] *Thomas*,[146] *Hadorn*,[147] and *Miller*.[148]

Hayseeds first introduced the concept of substantially prevailed, but did not define how to determine it. *Thomas* was the first case to define substantially prevailed. According to *Thomas v. State Farm Mutual Automobile Ins. Co.*,

> whether the insured has substantially prevailed against his insurance company on a property damage claim is determined by the status of the negotiations between the insured and the insurer prior to the institution of the lawsuit. Where the insurance company has offered an amount materially below the damage estimates submitted by the insured, and the jury awards the insured an amount approximating the insured's damage estimates,

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142 *Id.*

143 *Id.*

144 The court has enunciated different ways of determining whether an insured has substantially prevailed in the following cases: *Hayseeds*, 352 S.E.2d 73 (W. Va. 1986); *Thomas*, 383 S.E.2d 786 (W. Va. 1989); *Hadorn*, 456 S.E.2d 194 (W. Va. 1995); and *Miller*, 500 S.E.2d 310 (W. Va. 1997).

145 352 S.E.2d 73 (W. Va. 1986).

146 383 S.E.2d 786 (W. Va. 1989).

147 456 S.E.2d 194 (W. Va. 1995).

148 500 S.E.2d 310 (W. Va. 1997).

the insured has substantially prevailed.[149]

In *Thomas*, the plaintiff's truck was wrecked. He estimated the loss at $10,231.05. State Farm offered $4,960.72.[150] The jury awarded the insured $13,213.[151] Obviously, a jury verdict for the plaintiff for an amount more than he requested satisfies the substantially prevailed standard.

In *Hadorn v. Shea*,[152] the insured pursued an underinsured motorist claim against his insurer. The insured made a demand on State Farm for $300,000. State Farm responded by offering the insured $15,000. The insured rejected this settlement offer. In response, State Farm increased its offer to $22,500. The insured rejected that offer and demanded $300,000 during the entire negotiation period. After the case was tried, the jury awarded the insured $90,000.

The insured did not substantially prevail. The plaintiff's last settlement demand of $300,000 before filing suit was compared to the jury verdict of $90,000. State Farm offered $22,500, which is closer to the amount awarded by the jury than to the amount that the plaintiff demanded. The jury award was $210,000 less than the amount the plaintiff requested before trial, and $67,500 more than State Farm's offer. These three figures indicate that the plaintiff did not substantially prevail. This looks like math: who is closer to the jury verdict? Nonetheless, the court warned that it "[did] not advocate such a purely mechanical approach to deciding the question of whether a plaintiff 'substantially prevails.'"[153]

The court in *Hadorn* also considered other factors in determining whether the plaintiff substantially prevailed. First, it determined that it did not appear that the plaintiff was interested in settlement for any amount less than her original demand of $300,000.[154] The plaintiff did not negotiate in that she did not waiver from her original demand. Second, the court found that the plaintiff did not prove "but for" her attorney's services she would not have been able to get State Farm to settle for $90,000 without proceeding to trial. Thus, instead of using a mechanical approach to determine whether the insured substantially prevailed, the court in *Hadorn* "considered the status of the claim at the time negotiations broke down, which included consideration of the insured's interest in attempting settlement before trial."[155]

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149 383 S.E.2d at 790-91.

150 *Id.* at 791.

151 *Id.* at 788.

152 456 S.E.2d 194 (W. Va. 1995).

153 *Id.* at 197.

154 *Id.* at 198.

155 *Id.*

The most recent case, *Miller v. Fluharty*,[156] has enunciated a much more flexible test to determine whether the plaintiff has substantially prevailed. *Miller* stated that "whether a policyholder has substantially prevailed is determined by looking at the totality of the policyholder's negotiations with the insurance carrier, not merely the status of negotiations before and after a lawsuit is filed."[157] According to this case, negotiations must be looked at as a whole, including whether the policyholder's demand is reasonable and whether the insurer promptly responded.[158]

2. When does substantially prevail apply?

Is an insured still entitled to attorney's fees if he substantially prevails even though he settles before going to trial? In *Jordan v. Nat. Grange Mutual Ins. Co.*,[159] the court determined that an insured

> "substantially" prevails in a property damage action against his or her insurer when the action is settled for an amount equal to or approximating the amount claimed by the insured immediately prior to the commencement of the action, as well as when the action is concluded by a jury verdict for such an amount.[160]

In *Jordan*, the insured plaintiff filed a civil action against the insurer and then settled for $40,000. The settlement was silent as to an amount of attorney's fees. The plaintiffs did not cash the settlement check because they believed that the insurer should pay for their reasonable attorney's fees. The insurer sought enforcement of the settlement agreement and objected to payment of the attorney's fees.

The Court held that a settlement can be analogized to a judgment with respect to the award of reasonable attorney's fees. It reasoned that "it is incongruous to require [a] plaintiff to bypass a settlement offer and proceed to trial in order to 'earn' counsel fees, especially when a settlement and trial would have substantially achieved the same result."[161] However, in settlement situations, the plaintiff must meet an extra requirement, that "the attorney's services were

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156 500 S.E.2d 310 (W. Va. 1997).

157 *Id.* at 321.

158 *Id.*

159 393 S.E.2d 647 (W. Va. 1990).

160 *Id.* at 652. (quoting Van Houten v. New Jersey Manufacturers Ins. Co. 387 A.2d 419, 421 (N.J. Passaic County Dist. Ct. 1978), *aff'd* 406 A.2d 984 (N.J. App Div. 1979)).

161 *Id.* at 651.

necessary to obtain payment of the insurance proceeds."[162] In determining the necessity of the attorney's services, "the insured must show that but for his or her attorney's services such settlement would not have been reached . . . ."[163]

The substantially prevailed standard was also extended to appraisal proceedings in *Smithson v. United States Fidelity & Guaranty Co.*.[164] In *Smithson*, the plaintiffs obtained an insurance policy with a $60,000 limit on their truck. The truck was destroyed in an explosion, and the insured submitted a proof of loss for the value of the truck to the insurance company. The two parties could not agree on the actual cash value of the truck, so the insurance company invoked the appraisal procedure provided for in the policy. The loss was appraised at $67,000, which exceeded the policy limits. The insured then sued the insurance company because he had substantially prevailed. The plaintiff proved a loss in excess of policy limits of $60,000, whereas the insurer offered $25,000. The court found that "a first-party suit based on *Hayseeds* will not be barred by the settlement of the loss in an appraisal proceeding under the fire insurance policy if the insured substantially prevailed in the appraisal proceeding over the amount of the loss."[165] Thus, *Smithson* extended substantially prevailed to appraisal proceedings. Plaintiffs can substantially prevail by either verdict (as in *Hayseeds* and *Thomas)*; by settlement (as in *Jordan)*; or by appraisal (as in *Smithson).*

Until *Marshall v. Saseen*[166] was decided in 1994, the substantially prevailed standard only applied to property insurance. The *Marshall* case involved an underinsured motorist claim. The Court extended the substantially prevailed test to all first party insurance claims by stating that "[a]lthough we recognize that *Hayseeds* and its progeny involved insurance policies covering property damage claims, we can see no reason why these principles should not apply to uninsured and underinsured motorist coverage."[167] It extended the *Hayseeds* substantially prevailed test to uninsured and underinsured motorist coverage because these types of coverage, just like property damage coverage, constituted first party insurance. It determined that the reasoning behind the substantially prevailed standard applied to all types of first party insurance.

3. What types of damages are recoverable?

After an insured proves that he has substantially prevailed, he is entitled to a whole array of consequential and compensatory damages. These damages include

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162 *Id.* at 652.

163 *Id.*

164 411 S.E2d 850 (W. Va. 1991).

165 *Id.* at 858.

166 450 S.E.2d 791 (W. Va. 1994).

167 *Id.* at 797.

attorney's fees, net economic loss, and aggravation and inconvenience (emotional distress, anger, anguish, chagrin, depression, disappointment, embarrassment, fear, fright, grief, horror, humiliation, shame, and worry).[168]

First, the insured is entitled to recover attorney's fees. There are two ways to determine attorney's fees. The first method, described in *Hayseeds*, stated that "[p]resumptively, reasonable attorneys' fees . . . are one-third of the face amount of the policy, unless the policy is either extremely small or enormously large."[169] The court then went on to explain that "when a claim is for under $20,000 or for over $1,000,000 (to take numbers that are applicable in 1986) the court should then inquire concerning what 'reasonable attorneys' fees' are."[170]

The second method is the twelve-factor *Pitrolo* test:

> Where attorney's fees are sought against a third party, the test of what should be considered a reasonable fee is determined not solely by the fee arrangement between the attorney and his client. The reasonableness of attorney's fees is generally based on broader factors such as: (1) the time and labor required: (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the undesirability of the case; (11) the nature and length and the professional relationship with the client; and (12) awards in similar cases.[171]

Landmark Baptist Church[172] is the key case applying the *Pitrolo* test. The argument was that the plaintiff had not sufficiently proven the amount of attorney's fees. The plaintiff submitted per hour fee arrangement documentation; detailed monthly statements showing time, services rendered, charges for services, and expenses advanced; and an affidavit from the pastor of the insured church indicating his belief that the fees were reasonable. The court found that the information submitted by the plaintiff was enough to determine if the fees were reasonable using the twelve factors.[173] It also stated that the trial court had wide discretion in determining

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168 *Hayseeds*, 352 S.E.2d at 80.

169 *Id.*

170 *Id.*

171 Aetna Cas. & Sur. Co. v. Pitrolo, 342 S.E.2d 156, 157 Syl. Pt. 4 (W. Va. 1986).

172 484 S.E.2d 195 (W. Va. 1997).

173 *Id.* at 198.

the reasonableness of the fees because it had first-hand knowledge of the case and the legal work involved.[174]

Plaintiffs are also entitled to recover for net economic loss.[175] These damages "must be proved with reasonable certainty."[176] In *Smithson*, the plaintiff's only evidence to support his economic loss was his testimony of an estimate of lost profits.[177] He did not prove this loss by any detailed evidence from the partnership accounts or tax returns. The court found that "loss of profits cannot be based on estimates which amount to mere speculation and conjecture but must be proved with reasonable certainty."[178] Therefore, it determined that the plaintiff's evidence was insufficient to prove any net economic loss.

Finally, if they substantially prevail, insureds are entitled to recover damages for aggravation and inconvenience.[179] These damages represent those that would be recoverable for emotional distress. In the *Restatement (Second) of Torts*, the term emotional distress "passes under various names, such as mental suffering, mental anguish, mental or nervous shock, or the like. It includes all highly unpleasant mental reactions such as fright, horror, grief, shame, humiliation, embarrassment, anger, chagrin, disappointment, worry and nausea."[180] In *Mutafis v. Erie Ins. Exchange*,[181] the insured plaintiff recovered damages for aggravation and inconvenience by giving testimony that she suffered "anguish, embarrassment, shame, anger, and depression" as a result of her insurer's conduct.[182]

Why has West Virginia established this substantially prevailed standard? West Virginia "adopted this rule in recognition of the fact that, when an insured purchases a contract of insurance, he buys insurance — not a lot of vexatious, time consuming, expensive litigation with his insurer."[183] The court believed that an insurer has a contractual obligation to its insured, and when it violates that obligation, the insured should be compensated for his expenses incurred as a result of the violation, including attorney's fees and expenses arising from litigation.[184]

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174 *Id.* at 199.

175 *Hayseeds*, 352 S.E.2d at 80.

176 Smithson v. United States Fidelity & Guaranty Co., 411 S.E.2d 850, 861 (W. Va. 1991) (quoting Kentucky Fried Chicken of Morgantown v. Sellaro, 214 S.E.2d 823 (W. Va. 1975)).

177 *Id.* at 861.

178 *Id.* at 862 (quoting State *ex rel.* Shatzer v. Freeport Coal Co. 107 S.E.2d 503, 505 Syl. Pt. 5 (W. Va. 1959).

179 *Hayseeds*, 352 S.E.2d at 80.

180 RESTATEMENT (SECOND) OF TORTS § 46 (j).

181 328 S.E.2d 675 (W. Va. 1985).

182 *Id.* at 690.

183 *Hayseeds*, 352 S.E.2d at 79.

184 *Id.*

The substantially prevailed standard applies only in West Virginia, only to first party claims, and only to common law *Hayseeds* actions.[185] In addition, West Virginia is the only state not to require wrongful conduct on the part of the insurance company in a cause of action for insurance company claim misconduct.[186] This standard results in a form of strict liability for insurance companies. When an insurance company engages in misconduct in West Virginia, it is essentially acting at its peril, or to paraphrase Stephen Ashley, if an insurer in West Virginia decided to deny or lowball a claim, it had better be right. If it is wrong, it pays.[187]

C. *The Insurer Must Have Acted In Bad Faith*

Bad faith plays no part in this cause of action. The standard is substantially prevails. The court in *Hayseeds* "consider[ed] of little importance whether an insurer contests an insured's claim in good faith or bad faith. In either case the insured is out his consequential damages and attorney's fees."[188] It then explained that bad faith short of actual malice no longer belonged in property damage insurance cases.[189] Therefore, West Virginia is a strict liability state with regard to insurance company claim misconduct.

However, bad faith is one of the sequential steps in *Marshall*.[190] Bad faith is included because it allows an insured plaintiff to recover excess over policy proceeds.[191] The court's position is that substantially prevailed is not enough to obtain the excess.[192] Therefore, bad faith is necessary to recover the excess over policy proceeds.

Marshall involved a claim for underinsured proceeds. The plaintiff demanded policy limits of $100,000, but the insurer declined and instead offered $10,000.[193] At trial the jury awarded the plaintiff $176,711.80.[194] The plaintiff substantially prevailed and was entitled to collect the $100,000 policy proceeds and all consequential and compensatory damages. The plaintiff wanted the $76,711.80 in excess over the policy proceeds. The court held that the plaintiff must prove bad

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185 Marshall v. Saseen, 450 S.E.2d 791, 797 (W. Va. 1994).

186 *See* Henderson, *supra* note 37, at 1155.

187 Miller v. Fluharty, 500 S.E.2d 310, 321 (W. Va. 1997) (citing STEPHEN S. ASHLEY, BAD FAITH ACTIONS § 5:08 (1984)).

188 *Hayseeds*, 352 S.E.2d at 79.

189 *Id.* at 81.

190 450 S.E.2d 791 (W. Va. 1994).

191 *Id.* at 798.

192 *Id.*

193 *Id.* at 794.

194 *Id.*

faith in order to recover this excess.[195]

Bad faith by a first party insurer is unreasonable conduct.[196] Once a plaintiff proves this, he has proved prima facie bad faith. The burden then shifts to the insurance company to prove good faith.[197] In *Marshall,*[198] the *Shamblin*[199] test was used. This test, which is used to determine whether an insurer is liable for the excess over the policy limits, asks "whether the reasonably prudent insurer would have refused to settle within policy limits under the facts and circumstances, bearing in mind always its duty of good faith and fair dealing with the insured."[200] To determine whether the insurer's efforts to settle are reasonable, the trial court should consider the following:

> Whether there was appropriate investigation and evaluation of the claim based upon objective and cogent evidence; whether the insurer had a reasonable basis to conclude that there was a genuine and substantial issue as to liability of its insured; and whether there was potential for substantial recovery of an excess verdict against its insured. Not one of these factors may be considered to the exclusion of the others.[201]

The court also stated that this issue was to be determined in another suit where the burden was on the insurer to prove that it attempted in good faith to negotiate a settlement.[202] Therefore, *Marshall* extended the *Shamblin* test of bad faith to all first party insurance cases.

Do not confuse excess over policy proceeds damages with compensatory damages recoverable when an insured substantially prevails. Excess over policy proceeds represents the amount awarded by the jury above the amount of the insured's policy limit. For example, in *Marshall* the judgment awarded against the insurance company was $176,711.80.[203] The insured's policy limit was $100,000; therefore, the $76,711.80 represented the excess. Bad faith in first party insurance requires the insurer to pay all damages in excess of policy proceeds.[204]

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195 *Marshall*, 450 S.E.2d at 798.

196 *Id.*

197 *Id.*

198 *Id.*

199 Shamblin v. Nationwide Mut. Ins. Co., 396 S.E.2d 766 (W. Va. 1990).

200 *Id.* at 768 Syl. Pt. 4.

201 *Marshall*, 450 S.E.2d at 798; *Shamblin*, 396 S.E.2d at 768 Syl. Pt. 4.

202 *Marshall*, 450 S.E.2d at 798.

203 *Id.* at 794.

204 *Id.* at 798.

D. The Insurer Must Have Acted With Actual Malice

The last sequential step in a prima facie cause of action is actual malice. Actual malice unlocks Pandora's box of punitive damages. Actual malice occurs when "the company actually knew that the policyholder's claim was proper, but willfully, maliciously, and intentionally denied the claim."[205] This standard is high to prevent the award of punitive damages.[206] Because the court has lowered the standard of liability, it has raised the bar to recover punitive damages.[207] The trial court should allow the jury to decide upon compensatory damages to be decided upon by the jury, but not upon punitive damages.

Actual malice is not negligence, lack of judgment, incompetence, or bureaucratic confusion.[208] "An offer of settlement can never be used to show 'actual malice' nor be used against an insurance carrier in any way."[209] An example of actual malice would be a "company-wide policy of delaying the payment of just claims through barraging the policyholder with mindless paperwork."[210]

In all of the eighteen first party common law insurance misconduct cases, no insurance company has been found guilty of actual malice.[211] This illustrates the policy of a trade-off that allows plaintiffs to recover damages under the low threshhold substantially prevails standard, but not punitive damages under the actual malice standard.

Punitive damages also involve due process problems. The United States Supreme Court stated that "[t]he Due Process Clause of the Fourteenth Amendment prohibits a State from imposing a grossly excessive punishment on a tortfeasor."[212] The West Virginia Supreme Court mandated a review of a punitive damage award to determine if the award is excessive.[213] A distinction is made between those defendants who did not intentionally or malevolently harm a plaintiff and those defendants who intentionally or malevolently committed acts they knew to be harmful.[214] Where the defendant has acted with extreme negligence

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205 *Hayseeds*, 352 S.E.2d at 80-81. In the opinion of the author this would be a perfect jury instruction on actual malice.

206 *Id.* at 81.

207 *Id.*

208 *Id.*

209 *Id.*

210 *Hayseeds*, 352 S.E.2d. at 81 n.2.

211 For a list of the eighteen cases, see *supra* Part IV.A-R.

212 BMW of North America, Inc. v. Gore, 517 U.S. 559, 562 (1996).

213 Garnes v. Fleming Landfill, Inc., 413 S.E.2d 897, 900 Syl. Pt. 5 (W. Va. 1991).

214 TXO Production Corp. v. Alliance Resources Corp., 419 S.E.2d 870, 874 Syl. Pt. 15 (W. Va. 1992).

or wanton disregard but with no actual intention to cause harm, and where the compensatory damages are neither negligible nor very large, the limit of the ratio of punitive damages to compensatory damages is about five to one.[215] When the defendant acts with the "actual evil intention, much higher ratios are not per se unconstitutional."[216] As of this writing, the case concerning these due process controls is *Vandevender v. Sheetz, Inc.*[217] By adopting the above tests, this case stated that the objective of punitive damages awards "is the goal of ensuring that such awards will serve to deter similar conduct."[218]

VI. QUESTIONS AND ANSWERS / THE FUTURE

A. Bright Line Tests for Substantially Prevailed

One of the questions that still remains is how to prove whether the insured substantially prevailed. It is simple to determine that an insured substantially prevailed when the jury verdict is equal to or close to what the insured demanded. However, it is difficult to determine whether the insured substantially prevailed when the jury verdict is much less than what the insured demanded, but also much more than what was offered by the insurer. A bright line test would easily allow all to determine whether an insured substantially prevailed. Two examples of bright line tests are shown below. The first test, suggested by Richard Costella, would provide that

> [a]n insured "substantially prevails" in a property damage action against his or her insurer when the action is settled for an amount equal to or in approximating the amount claimed by the insured immediately prior to the commencement of the action, as well as when the action is concluded by a jury verdict for such an amount.[219]

This test involves adding the last demand by the insured and the last offer by the insurer, dividing by two, and then comparing that figure to the amount of the jury verdict. If the jury verdict is more than the computed figure, then the insured substantially prevailed, and if the jury verdict is less than the computed figure, then the insured did not substantially prevail. This test is "simple and concise" and will "promote efficiency, predictability, and uniformity in the determination of whether

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215 *Id.* at 888.

216 *Id.* at 874 Syl. Pt. 15.

217 490 S.E.2d 678 (W. Va. 1997) (per curiam).

218 *Id.* at 691.

219 Richard Costella, Note, *Substantially Prevailed Damages: Fee Shifting in West Virginia Insurance Law*, 99 W. VA. L. REV. 811, 826 (1997).

an insured substantially prevailed in an action against his or her insurer."[220]

The second test of determining substantially prevailed is to compare what the insured demanded and what the insurer offered to the jury verdict. If the jury verdict is more than what the insurer offered, then the insured substantially prevailed by the percentage of the jury verdict to the insured's demand. For example, assume that the insured demanded $100,000, the insurer offered $50,000, and the jury awarded $70,000. The jury verdict is more than the insurer's offer, so the insured substantially prevails. The insured's consequential damages are the percentage of the jury verdict to the insured's demand, which is $70,000/$100,000 or 70%.

B. *To What Kinds of Insurance Will Hayseeds Attach?*

Another question that still remains is to what other kinds of insurance will *Hayseeds* apply. The courts have already applied the substantially prevailed standard to fire,[221] life,[222] uninsured motorist,[223] underinsured motorist,[224] and collision insurance.[225] *Hayseeds* should not apply to all first party insurance company misconduct claims. All insurance is purchased for the same reason: protection.

C. *Defenses*

An area of insurance law that has not yet been mentioned is defenses. Insurance companies in West Virginia are subject to the risk of damages more than in any other state.[226] Therefore, insurance companies need to be aware of the different types of defenses to protect themselves from liability for insurance company claim misconduct. One defense available to insurance companies is the statute of limitations. Although insurance company claim misconduct is generally treated as a tort, the general rule is, where a case sounds both in contract and tort the plaintiff will ordinarily have freedom of election between an action of tort and

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220 *Id.*

221 Firstbank Shinnston v. West Virginia Ins. Co., 408 S.E.2d 777 (W. Va. 1991); Smithston v. United States Fidelity Guaranty Co., 411 S.E.2d 850 (W. Va. 1991); Jordan v. National Grange Mut. Ins. Co., 393 S.E.2d 647 (W. Va. 1990); Hayseeds Inc. v. State Farm Fire & Cas., 352 S.E.2d 73 (W. Va. 1986).

222 D'annunzio v. Security Connecticut Life Ins. Co., 410 S.E.2d 275 (W. Va. 1991).

223 Burgess v. Porterfield, 469 S.E.2d 114 (W. Va 1996); State *ex rel.* State Farm Mut. Auto Ins. Co. v. Canady, 475 S.E.2d 107 (W. Va. 1996); Weese v. Nationwide Ins. Co., 879 F.2d 115 (4th Cir 1989).

224 Hadorn v. Shea, 456 S.E.2d 194 (W. Va. 1995); Marshall v. Saseen, 450 S.E.2d 791 (W. Va. 1994); Arnot v. Burdette, 434 S.E.2d 394 (W. Va. 1993).

225 Thomas v. State Farm Mut. Auto Ins. Co., 383 S.E.2d 786 (W. Va. 1989).

226 Insurance companies are subject to the risk of damages in West Virginia more than in any other state because of West Virginia's unique rule of substantially prevails.

one of contract.[227] Of course, in West Virginia the plaintiff will want the court to adopt the contract statute of limitations, which is 10 years under W. Va. Code section 55-2-6. However, the defendant can argue that the tort statute of limitations of two years should apply to insurance company claim misconduct cases. The majority rule throughout the country is to apply the contract statute of limitations.[228]

Comparative bad faith is another possible defense. This defense is raised to an action brought by the insured alleging insurance company claim misconduct to "reduce or negate claimed extra-contractual damages."[229] When the insurer pleads the comparative bad faith defense, the conduct of the insured is analyzed according to the comparative fault principles used in negligence cases.[230] When raising this defense, the insurance company should raise it as an affirmative defense to avoid having it waived.[231]

In contrast to comparative bad faith is the defense of reverse bad faith. Reverse bad faith is an affirmative claim / cause of action by an insurer against its insured for losses sustained by the insurer as a result of the insured's conduct. Examples of these types of losses include "payment made to an innocent co-insured; payment made to a mortgagee for loss occasioned by an insured's fraud such as arson; investigation costs incurred that revealed the insured's fraud; and lost subrogation rights."[232]

Another defense available to insurance companies is the "advice of counsel" defense. The advice of counsel defense is raised to prove that the insurer did not commit insurance company claim misconduct because it relied on its advice of counsel to make its decisions.[233] This defense can also be offered to mitigate claimed punitive damages.[234] The "advice of counsel" defense has four requirements: "(1) The insurer disclosed to the attorney all information necessary to make the coverage determination; (2) The attorney was acting as the insurer's attorney in providing the advice; (3) The insurer relied on counsel's advice in good faith; [and] (4) The insurer did, in fact, act on the advice."[235] In this defense, the attorney-client privilege is waived as to communications and documents relating to the advice. Therefore, when deciding to use this defense, the insurer must consider whether the benefits of the defense outweigh the protection afforded by the

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227 Eads v. Marks, 249 P.2d 257 (Cal. 1952) (*en banc*).

228 WILLIAM M. SHERNOFF ET AL., INSURANCE BAD FAITH LITIGATION § 20.07 [3] [B] (1998).

229 *Id.* at § 30.03[2].

230 *Id.*

231 *Id.*

232 *Id.*

233 SHERNOFF, supra note 228, at § 30.04[2].

234 *Id*

235 *Id.*

attorney-client privilege.[236]

D. Preemption by ERISA

Another issue that remains is preemption of first party insurance company claim misconduct actions. The Employee Retirement Income Security Act of 1974 (ERISA) is a federal statute designed to regulate employee benefit plans including group insurance plans.[237] ERISA preempts state common-law tort and contract actions asserting an insurer's improper processing of an employee's claim for disability benefits for an employment-related injury under an insured employee benefit plan.[238] However, before the ERISA preemption becomes an issue, it must first be determined whether the insurance policy is an ERISA plan:

An insurance policy is part of an ERISA plan if it is a plan, fund, or program established or maintained by an employer of an employee organization, or both, for the purpose of providing medical, surgical, hospital care, sickness, accident, disability, death, unemployment or vacation benefits, apprenticeship or other training programs, day-care centers, scholarship funds, prepaid legal services or severance benefits to participants or their beneficiaries.[239]

If it is determined that the insurance policy is an ERISA plan, then under ERISA's preemption clause, if a state law relates to employee benefits plans, it is preempted.[240] However, under ERISA's "insurance saving clause," laws that regulate insurance are saved from preemption.[241] The United States Supreme Court held that an employee's insurance company claim misconduct suit against a long-term disability insurer was preempted by ERISA's preemption clause and was not saved by the statute's saving clause.[242] The Court reasoned that even though the Mississippi law of insurance company claim misconduct deals with the insurance industry, the law developed from general principles of tort and contract law and was therefore not considered a law the "regulates insurance" within the meaning of ERISA's saving clause.[243]

The West Virginia Supreme Court in *Ball v. Life Planning Services, Inc.*[244]

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236 *Id.*

237 *Id.* at § 5.07[2][a].

238 29 U.S.C. § 1144(a) (1994) (allowing for preemption of any and all state laws insofar as they relate to any employee benefit plan).

239 29 U.S.C. § 1002(1) (1994).

240 *Id.*

241 Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41 (1987).

242 *Id.*

243 *Id.* at 49-50.

244 421 S.E.2d 223 (W. Va. 1992).

was asked to determine whether W. Va. Code sections 33-12-21 and 33-11-4(9) were preempted by ERISA.[245] The court found that W. Va. Code section 33-12-21, which imposes personal liability upon "any agent or broker who participates directly or indirectly in effecting any insurance contract, except authorized reinsurance, upon any subject of insurance resident, located or to be performed in this State, where the insurer is not licensed to transact insurance in this State," has only a tenuous effect on employee welfare benefit plans and does not "relate to" employee welfare benefit plans within the meaning of ERISA.[246] Thus, actions brought against agents or brokers under this statute are not preempted by ERISA. However, the court found that ERISA did preempt W. Va. Code section 33-11-4(9) because this statute is the unfair claim settlement practices statute that is the same type of statute that the Supreme Court determined was preempted in *Pilot Life Insurance Co. v. Dedeaux.*[247]

PART II: FIRST PARTY STATUTORY INSURANCE MISCONDUCT

I. INTRODUCTION

West Virginia law of statutory misconduct is broad. In fact, West Virginia is one of only eight jurisdictions that allow a private cause of action for violation of the Unfair Trade Practices Act.[248] The Act provides a comprehensive list of prohibited practices by insurance companies. If an insurance company violates the Act, a plaintiff may bring a private cause of action for such violation. There are a plethora of damages available. If an insurance company committed violations with actual malice, then punitive damages are awarded. Unfortunately, the law of statutory misconduct in West Virginia is confusing. This section will explain statutory misconduct law, thus providing a cohesive guide for practitioners, judges, and insurers.

II. HISTORY

A. National

The history of statutory insurance bad faith begins in 1944 when the U.S. Supreme Court decided in *United States v. Southeastern Underwriters Ass'n.*[249] that the insurance business was part of interstate commerce and therefore subject to

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245 *Id.* at 223.

246 *Id.* at 224.

247 *Id.* at 227.

248 W. VA. CODE § 33-11-4 (1996).

249 322 U.S. 533 (1944).

federal laws.[250] Within a year of that decision, Congress passed the McCarran-Ferguson Act,[251] which placed the regulation of insurance primarily with the states. All but six states have adopted some form of the Unfair Trade Practices Act to regulate insurance.[252] Forty-five states have adopted regulations based on Model Acts promulgated by the National Association of Insurance Commissioners (NAIC).[253]

B. West Virginia

West Virginia adopted its version of the NAIC Model Act in 1957.[254] In 1981, the West Virginia Supreme Court in *Jenkins v. J.C. Penney Casualty Insurance Co.*[255] allowed a private cause of action under the West Virginia Unfair Claims Settlement Practices section[256] of the West Virginia Unfair Trade Practices Act.[257] *Jenkins* involved a third party plaintiff, but the Court later expanded the cause of action to first party plaintiffs in *Thompson v. W. Va. Essential Property Insurance Co.*[258] In addition to providing a private cause of action under the Unfair Claims Settlement Practices provisions, the Court has allowed private causes of action under other parts of the Unfair Trade Practices Act. In *Morton v. Amos-Lee Securities*,[259] a private cause of action was allowed for misrepresentation and false advertising of insurance policies.[260] In *Mutafis v. Erie Insurance Exchange*,[261] a private cause of action was allowed under the "Defamation" section[262] and the

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250 *Id.* at 551-62.

251 *See* 15 U.S.C. § 1011-15 (1994).

252 SHERNOFF, *supra* note 228, at § 6.03[2].

253 *Id.*

254 *See* W. VA. CODE § 33-11-4 (1996). Although technically the West Virginia Unfair Trade Practices Act includes sections other than "33-11-4," for purposes of this section, and for practical purposes, we shall refer to the Act as "33-11-4" only as the West Virginia Unfair Trade Practices Act.

255 280 S.E.2d 252 (W. Va. 1981), *overruled on other grounds by* State *ex rel.* State Farm Fire & Cas. Co. v. Madden, 451 S.E.2d 721 (W. Va. 1994).

256 W. VA. CODE § 33-11-4(9) (1996).

257 .W. VA. CODE § 33-11-4 (1996).

258 411 S.E.2d 27, 34-35 (W. Va. 1991), *overruled on other grounds by* State *ex rel.* State Farm Fire & Cas, Co. v. Madden 452 S.E.2d 721 (W. Va. 1994) *as explained in* Light v. Allstate Ins. Co. No. 24365 (W. Va. July 7, 1998).

259 466 S.E.2d 542, 547 (W. Va. 1995).

260 W. VA. CODE § 33-11-4(1) (1996).

261 328 S.E.2d 675 (W. Va. 1985).

262 W. VA. CODE § 33-11-4(3) (1996).

"False statements and entries" section.[263] To date, most litigation has been based on the Unfair Claims Settlement Practices Act.[264] Presumably, a private cause of action would be allowed under any section of the Unfair Trade Practices Act.

III. NATIONAL NORM

Most states that have adopted an act allow only an administrative remedy.[265] Eight states, however, allow a private cause of action against insurers. Florida has a statute that provides for a private cause of action to be brought under its act.[266] Texas,[267] Massachusetts,[268] and Louisiana[269] have similar statutes. Other states have private causes of action that have been judicially imposed, including Kentucky,[270] Montana,[271] North Dakota,[272] and West Virginia.[273] Although California was the first state to allow a private cause of action under its common law in *Royal Globe Insurance Co. v. Superior Court*,[274] that decision was overruled nine years later in *Moradi-Shalal v. Fireman's Fund Insurance Co.*[275] The Arizona Supreme Court once allowed a cause of action, but that case was superceded by statute.[276]

IV. WEST VIRGINIA LAW- OVERVIEW

West Virginia law provides both statutory law[277] and administrative

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263 W. VA. CODE § 33-11-4(5) (1996).

264 W. VA. CODE § 33-11-4(9) (1996).

265 SHERNOFF, *supra* note 228, at § 6.03 [3].

266 FLA. STAT. ANN. § 624.155 (1996).

267 TEX. INS. CODE ANN. § 21.21 (West 1996).

268 MASS. ANN. LAWS ch. 93A, § 9 (1994).

269 LA. REV. STAT. ANN. § 22:1220 (1995).

270 *See* State Farm Mut. Auto. Ins. Co. v. Reeder, 763 S.W.2d 116 (Ky. 1989).

271 *See* Klaudt v. Flink, 658 P.2d 1065 (Mont. 1983), modified by statute *as explained in* O'Fallon v. Farmer's Ins. Exchange 859 P.2d 1008 (Mont. 1993).

272 *See* Farmer's Union Cent. Exch., Inc. v. Reliance Ins. Co, 626 F. Supp. 583 (D.N.D. 1985).

273 *See* Jenkins v. J.C. Penney Casualty Ins. Co., 280 S.E.2d 252 (W. Va. 1981), *overruled on other grounds by* State *ex rel.* State Farm Fire & Cas. Co. v. Madden 451 S.E.2d 72 (W. Va. 1994).

274 592 P.2d 329 (Cal. 1979).

275 758 P.2d 59 (Cal. 1988).

276 ARIZ. STAT. ANN. § 20-461 (1997).

277 W. VA. CODE § 33-11-4 (1996) is the Unfair Trade Practices Act in West Virginia. W. VA. CODE § 33-11-4(9) is the section prohibiting unfair claims settlement practices.

regulations[278] to prevent statutory insurance misconduct. Although the administrative regulations provide only an administrative relief, the court has provided for a private cause of action for violations of the Unfair Trade Practices Act.[279]

A. Statutes

West Virginia passed its Unfair Trade Practices Act in 1957.[280] The Act has several sections. Section 33-11-4, entitled "Unfair methods of competition and unfair or deceptive acts or practices defined," establishes the statutory definitions of unfair trade practices.[281] The violation and interpretation of this section are the subject of most statutory misconduct litigation. The Act is referred to as being only section 4, even though that is technically not the case.[282] The Act does not expressly provide for a private cause of action.[283] The court, however, has construed the Act to provide a private cause of action.[284] We examine each of the subsections of the Act in turn.

1. West Virginia Code section 33-11-4(1)

West Virginia Code section 33-11-4(1) involves "[m]isrepresentation and false advertising of insurance policies."[285] *Morton v. Amos-Lee Securities*[286] is the

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278 W. VA. CODE STATE R. tit.114 §114-14(1-9) (1987).

279 Morton v. Amos-Lee Securities, 466 S.E.2d 542, 547 (W. Va. 1995).

280 W. VA. CODE § 33-11-4 (1996).

281 *Id.*

282 The West Virginia Unfair Trade Practices Act is actually sections 33-11-1 through 9. However, because section 4 is the only section that is significant to litigation, we refer to it as the Act and subsequently break it down into its various subsections.

283 W. VA. CODE § 33-11-4 *et. seq.* (1996).

284 *Morton*, 466 S.E.2d at 547.

285 W. VA. CODE § 33-11-4(1) (1996). This statute states as follows:

(1) Misrepresentation and false advertising of insurance policies. No person shall make, issue, circulate, or cause to be made, issued or circulated, any estimate, circular, statement, sales presentation, omission or comparison which:
(a) Misrepresents the benefits, advantages, conditions or terms of any insurance policy; or
(b) Misrepresents the dividends or share of the surplus to be received on any insurance policy; or
(c) Make any false or misleading statements as to the dividends or share of surplus previously paid on any insurance policy; or
(d) Is misleading or is a misrepresentation as to the financial condition of any person, or as to the legal reserve system upon which any life insurer operates; or
(e) Uses any name or title of any insurance policy or class of insurance policies misrepresenting the true nature thereof; or

only case that the court heard involving this subsection. In that case, the insured-deceased was a clothing salesman who was an "unsophisticated investor."[287] He inherited some money and sought investment counseling and advice from Richard Keagy, an employee of the defendant, Amos-Lee Securities, Inc.[288] The insured was eventually enrolled in a detoxification program for alcohol addiction.[289] Mr. Keagy recommended that the insured purchase a single-premium whole life insurance policy through Equitable.[290] The insured was found to be ineligible to purchase the policy because of his alcoholism.[291] Mr. Keagy then suggested that the insured take out a single-premium whole life insurance policy on the life of a relative, and suggested the insured's niece.[292] The insured rejected this idea, so Mr. Keagy and Mr. Funderburk, Equitable's agency manager in West Virginia, suggested that the insured purchase a life annuity instead.[293] At the time of that suggestion, Mr. Funderburk had actual knowledge that the insured had been rejected for life insurance because of his alcoholism.[294] The insured died about a year later.[295] The plaintiff, the insured's executor, brought suit alleging misrepresentation and fraud, breach of the duty of good faith and fair dealing, and a violation of West Virginia Code section 33-11-4(1)(a), because the defendants knew that the insured's health was too poor to make a life annuity a good investment.[296] The court, as a matter of first impression, held that "there is a private cause of action for a violation of W. Va. Code 33-11-4(1)(a), of the West Virginia Unfair Trade Practices Act."[297]

2. West Virginia Code Section 33-11-4(2)

West Virginia Code section 33-11-4(2) involves "[f]alse information and

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(f) Is a misrepresentation for the purpose of inducing or tending to induce the lapse, forfeiture, exchange, conversion or surrender of any insurance policy; or
(g) Is a misrepresentation for the purpose of effecting a pledge or assignment of or effecting a loan against any insurance policy; or
(h) Misrepresents any insurance policy as being shares of stock.

286 466 S.E.2d 542 (W. Va. 1995).

287 *Id.* at 543.

288 *Id.*

289 *Id.*

290 *Id.* at 544.

291 *Morton*, 466 S.E.2d at 544.

292 *Id.*

293 *Id.*

294 *Id.* at 545.

295 *Id.*

296 *Morton*, 466. S.E.2d at 546.

297 *Id* at 547.

advertising generally."[298] The statute prohibits untrue, deceptive, or misleading publications.[299] There are no cases involving this subsection yet. The court, however, will likely extend a private cause of action to this subsection, because it has extended private causes of action to the other subsections involving misrepresentation and false advertising of insurance policies and defamation.

3. West Virginia Code Section 33-11-4(3)

West Virginia Code section 33-11-4(3) involves "[d]efamation."[300] This section prevents defamatory statements against a person's financial condition.[301] *Mutafis v. Erie Ins. Exchange* is the only case involving violation of this statute.[302] In this case, the plaintiff, Ms. Mutafis, had reported the theft of her car to the defendant, Erie Insurance Exchange.[303] The defendant timely paid her claim.[304] Three weeks later, the plaintiff's cousin reported the theft of his vehicle to the defendant.[305] His claim was delayed because the defendant was "investigating [his] involvement."[306] He sued the insurance company and found that the following memo had been placed in both his and the plaintiff's file: "Please reference for your information to file #W017415, this is a relative and associated with mafia very

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298 W. VA. CODE § 33-11-4(2) (1996) provides that
[n]o person shall make, publish, disseminate, circulate or place before the public, or cause, directly or indirectly, to be made, published, disseminated, circulated or placed before the public, in a newspaper, magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster or over any radio or television station, or in any other way, an advertisement, announcement or statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his insurance business which is untrue, deceptive or misleading.

Id.

299 *Id.*

300 W. VA. CODE § 33-11-4(3) (1996). The statute provides that
[n]o person shall make, publish, disseminate or circulate, directly or indirectly, or aid, abet or encourage the making, publishing, disseminating or circulating of any oral or written statement or any pamphlet, circular, article or literature which is false, or maliciously critical of or derogatory to the financial condition of any person and which is calculated to injure such person

Id.

301 *Id.*

302 Mutafis v. Erie Ins. Exchange, 328 S.E.2d 675 (W. Va. 1985). The suit was being tried in Federal Court, this cite is to rulings by the Supreme Court of Appeals of West Virginia on a series of questions certified to it by the Fourth Circuit Court of Appeals.

303 *Id.* at 677.

304 *Id.*

305 *Id.*

306 *Id.*

heavily although may have NO connection whatever."[307]

Ms. Mutafis sued the insurance company for violating West Virginia Code sections 33-11-4(3), 33-11-4(5), the prohibitions on defamation and false statements and entries in the West Virginia Unfair Trade Practices Act.[308] The court found that "West Virginia law permits a private cause of action for violation of [section] 33-11-4(3,5),"[309] and that West Virginia Code section 33-11-4(3) "prohibits dissemination of false statements maliciously critical of or derogatory to a person's financial condition that are calculated to injure such person."[310] The court then ruled that "[c]ertainly it is maliciously critical of and derogatory to a person's financial condition to assert that she is closely associated with the mafia."[311] But the court added the caveat that "[i]n an action under either [of these provisions], there is a defense of qualified privilege completely coextensive with the defense of qualified privilege that existed heretofore in actions for defamation at common law."[312] Thus, "when a person publishes a statement in good faith about a subject in which he has an interest or duty and limits the publication of the statement to persons who have a legitimate interest in the subject matter, the writing or speech is privileged."[313] In this case, the court found that "[t]here is, of course, no privilege known to the common law of defamation protecting the intentional publication of false material."[314]

4. West Virginia Code Section 33-11-4(4)

West Virginia Code section 33-11-4(4) is entitled "[b]oycott, coercion and intimidation."[315] The statute is designed to prevent unreasonable restraint of or monopoly in the business of insurance.[316] The Court has not heard any cases involving violation of this subsection. It is difficult to imagine a private cause of

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307 *Mutafis*, 328 S.E.2d at 677.

308 *Id.* at 678. West Virginia Code section 33-11-3 prohibits defamation regarding the financial condition of any person that is calculated to injure that person. West Virginia Code section 33-11-5 prohibits knowingly filing, publishing, disseminating, circulating, or delivering any false material statement of fact as to the financial condition of a person.

309 *Mutafis*, 328 S.E.2d at 677 Syl. Pt. 5.

310 *Id.* at Syl. Pt. 1.

311 *Id.* at 679-80.

312 *Id.* at 677 Syl. Pt. 3.

313 *Id.* at 680.

314 *Mutafis*, 328 S.E.2d at 681.

315 W. VA. CODE § 33-11-4(4) (1996). This subsection provides that "[n]o person shall enter into any agreement to commit, or by any concerted action commit, any act of boycott, coercion or intimidation resulting in or tending to result in unreasonable restraint of, or monopoly in, the business of insurance."

316 *Id.*

action by an insured based on this subsection.

5. West Virginia Code Section 33-11-4(5)

West Virginia Code section 33-11-4(5) is the prohibition against "[f]alse statements and entries."[317] In *Mutafis v. Erie Insurance Exchange*,[318] the Court found that "West Virginia Law permits a private cause of action for violation of W. Va. Code sections 33-11-4(3) and (5)."[319] The Court also found that "W. Va. Code 33-11-4(5) prohibits the intentional inclusion in a private office file of any false material statement of fact as to the financial condition of a person."[320] This subsection of the statute seems to complement subsection (3), which prohibits defamation. Subsection (5) appears to allow a cause of action where the publication element of defamation is not present because publication took place only within a company's private files.

6. West Virginia Code Section 33-11-4(6)

West Virginia Code section 33-11-4(6) prohibits the issuance of agency company stock, other capital stock, benefit certificates, or shares in any corporation promising returns and profits as an inducement to insurance.[321] Presently, no cases on record involve a suit for violation of this subsection.

7. West Virginia Code Section 33-11-4(7)

West Virginia Code section 33-11-4(7) is the statutory prohibition of

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317 W. VA. CODE § 33-11-4(5) (1996). The subsection provides that
(a) No person shall knowingly file with any supervisory or other public official, or knowingly make, publish, disseminate, circulate or deliver to any person, or place before the public, or knowingly cause directly or indirectly, to be made, published, disseminated, circulated, delivered to any person or placed before the public, any false material statement of fact as to the financial condition of a person.
(b) No person shall knowingly make any false entry of a material fact in any book, report or statement of any person or knowingly omit to make a true entry of any material fact pertaining to the business of such person in any book, report or statement of such person.

318 328 S.E.2d 675 (W. Va. 1985). For a discussion of the facts of this case, *see* W. Va. Code Section 33-11-4(3) *supra*.

319 *Mutafis*, 328 S.E.2d at 677 Syl. Pt. 5

320 *Id.* at Syl. Pt. 2.

321 W. VA. CODE § 33-11-4(6) (1996) states that
[n]o person shall issue or deliver or permit agents, officers or employees to issue or deliver, agency company stock or other capital stock, or benefit certificates or shares in any common-law corporation, or securities or any special or advisory board contracts or other contracts of any kind promising returns and profits as an inducement to insurance.

"[u]nfair discrimination"[322] in the distribution of income. The court has not heard a case involving this subsection. It is reasonable to believe, however, that a private cause of action might be brought under this subsection.

8. West Virginia Code Section 33-11-4(8)

West Virginia Code section 33-11-4(8) prohibits the use of rebates to induce insurance.[323] Presently, no cases on record involve a suit for violation of this subsection.

9. West Virginia Code Section 33-11-4(9)

West Virginia Code section 33-11-4(9)[324] is West Virginia's version of the National Association of Insurance Commissioners (NAIC) model Unfair Claim Settlement Practices Act.[325] This is the most litigated subsection in West Virginia in terms of bad faith litigation, probably because it deals with the process of settling claims. This subsection is covered under section V, West Virginia Cause of Action for Violation of Unfair Claims Settlement Practices.

10. West Virginia Code Section 33-11-4(10)

West Virginia Code section 33-11-4(10)[326] involves "[f]ailure to maintain

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322 W. VA. CODE § 33-11-4(7) (1996) reads as follows:
(7) Unfair discrimination. (a) No person shall make or permit any unfair discrimination between individuals of the same class and equal expectation of life in the rates charged for any contract of life insurance or of life annuity or in the dividends or other benefits payable thereon, or in any other of the terms and conditions of such contract.
(b) No person shall make or permit any unfair discrimination between individuals of the same class and of essentially the same hazard in the amount of premium policy fees, or rates charged for any policy or contract of accident and sickness insurance or in the benefits payable thereunder, or in any of the terms or conditions of such contract, or in any other manner whatever.
(c) As to kinds of insurance other than life and accident and sickness, no person shall make or permit any unfair discrimination in favor of particular persons, or between insureds or subjects of insurance having substantially like insuring, risk and exposure factors or expense elements, in the terms or conditions of any insurance contract, or in the rate or amount of premium charge therefor. This paragraph shall not apply as to any premium or premium rate in effect pursuant to article twenty [33-20-1 et seq.] of this chapter.

323 W. VA. CODE §33-11-4(8) (1996).

324 W. VA. CODE § 33-11-4(9) (1996).

325 *See* W. VA. CODE § 33-11-4(9) (1996).

326 W. VA. CODE § 33-11-4(10) (1996) states as follows:
(10) Failure to maintain complaint handling procedures. -- No insurer shall fail to maintain a complete record of all the complaints which it has received since the date of its last examination under section nine [§ 33-2-9], article two of this chapter. This

complaint handling procedures." This section requires the company to keep a record of all complaints, their classification by line of insurance, the nature of each complaint, the disposition of the complaints, and the time to process each complaint.[327] No cases involving this subsection have come before the court. It is reasonable to believe, however, that a private cause of action could be brought under this subsection.

11. West Virginia Code Section 33-11-4(11)

West Virginia Code section 33-11-4(11)[328] prohibits the making of fraudulent statements in applications for insurance in order to gain a fee or commission from an insurer or broker. This section has not been before the court to date and is clearly designed to apply mainly to insurance solicitors.

B. Regulations

In addition to the code law, West Virginia also has a series of Unfair Trade Practices Regulations promulgated by the State Insurance Commission. The purpose of the regulations is to define practices "which constitute unfair methods of competition or unfair or deceptive acts or practices and to establish certain minimum standards and methods of settlements of . . . claims."[329] Like most administrative rules, these regulations have a private cause of action for violation of these regulations.[330] The penalty for violation of the regulations is determined by the Insurance Commissioner who may

> refuse to renew, or may revoke or suspend the license of [the violator] . . . [or may], at his discretion, order such person to pay to the State of West Virginia a penalty . . . [or] order such person to discontinue such illegal, improper or unjust transaction of

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record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of these complaints and the time it took to process each complaint. For purposes of this subsection, "complaint" shall mean any written communication primarily expressing a grievance.

327 *Id.*

328 W. VA. CODE § 33-11-4(11) (1996) reads as follows:
(11) Misrepresentation in insurance applications. No person shall make false or fraudulent statements or representations on or relative to an application for an insurance policy, for the purpose of obtaining a fee, commission, money or other benefit from any insurer, agent, broker or individual.

329 W. VA. CODE STATE. R. tit. 114 § 114-14-1(1.1(a)) (1987).

330 W. VA. CODE STATE R. tit. 114 § 114-14-9 (9.1) (1987). Such a cause of action would be unnecessary given the broad scope of the statutory Unfair Trade Settlement Practices Act, including the Unfair Claim Settlement Practices Act.

insurance and to adjust and pay obligations as they become due.[331]

These administrative rules cover the following unfair or deceptive acts or practices: standards for the acknowledgment of pertinent communications;[332] standards for prompt investigations and fair, and equitable settlements applicable to all insurers;[333] standards for prompt, fair and equitable settlements applicable to automobile insurance;[334] and separability.[335]

V. WEST VIRGINIA CAUSE OF ACTION FOR VIOLATION OF UNFAIR CLAIMS SETTLEMENT PRACTICES

The West Virginia Unfair Claims Settlement Practices Act is codified as West Virginia Code section 33-11-4(9).[336] Because this subsection of the Unfair Trade Practices Act is by far and away the most litigated, it deserves special treatment. A cause of action involves four sequential steps. Each successful step except for the second increases the damages to which the plaintiff is entitled. Successful litigation of each sequential step will entitle the plaintiff to a greater amount of damages. The sequential steps are as follows: (1) resolution of the policy coverage claim, after which a successful plaintiff is entitled to collect up to the proceeds of the policy; (2) violation of subsection (9); (3) violation of the statute by the defendant with such frequency as to indicate a general business practice, for which the plaintiff is entitled to damages for aggravation and inconvenience, attorney fees and costs, excess judgment over the policy limit, expenses, loss of consortium, and net economic loss; and (4) actual malice, allowing recovery of punitive damages. Beware of the bifurcation confusion. The sequential steps in a statutory cause of action should not be bifurcated.[337] All four steps in the cause of action should be tried together. The confusing nature of this cause of action, however, has led some courts to improperly bifurcate the steps.[338]

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331 *Id.*

332 *See* W. VA. CODE § 33-11-4(9) (1996); W. VA. CODE STATE R. tit. 114 § 114-14-5(1987).

333 *See* W. VA. CODE §33-11-4(9) (1996); W. VA. CODE STATE R. tit. 114 § 114-14-6 (1987).

334 *See* W. VA. CODE § 33-11-4(9) (1996); W. VA. CODE STATE R. tit. 114 § 114-14-7 (1987).

335 *See* W. VA. CODE § 33-11-4(9) (1996); W. VA. CODE STATE R. tit. 114 § 114-14-8 (1987).

336 W. VA. CODE § 33-11-4(9) (1996).

337 *See* McCormick v. Allstate Insurance Co., 475 S.E.2d 507, 519 (W. Va. 1996); *see also* discussion *infra* Part VI.A.

338 *See generally McCormick*, 475 S.E.2d at 510; *see also* discussion *infra* Part VI.C.

A. *Sequential Step One: Underlying Claim is Ultimately Resolved*

The first step is a resolution of the underlying claim in favor of the insured. This means nothing more than that the insured had a valid claim.[339] The court in *McCormick* so said, referring to *Jenkins v. J.C. Penney Casualty Insurance Company*.[340] Jenkins is the major case on third party statutory actions in West Virginia. The court there held that before the third party plaintiff can sue the liability insurer, the plaintiff must ultimately resolve his liability claim against the defendant.[341] The reasons for that rule are to avoid prejudice to the insurer and to test the plaintiff's satisfaction with his tort remedy. In first party cases, the reason for this step is to determine whether the plaintiff-insured has a valid claim. If there is no valid claim, there is no statutory cause of action. Upon resolution of the underlying policy claim, the plaintiff is entitled to recover up to the policy proceeds.[342]

B. *Sequential Step Two: Violation of the Statute*

The second step is to show a violation of section 33-11-4(9).[343] There is little jurisprudence to help determine the meaning of the substantive words in most of the subparagraphs. For example, subparagraph (f) contains the language "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear."[344] The words in bold have not been defined by the court. We suggest the following: good faith means that an insurer did not act unreasonably by failing to compensate the insured, without proper cause, for a loss covered by the policy.[345] We suggest that "prompt" should be defined by the state insurance regulations. Under the regulations, an insurer must acknowledge the receipt of a notification of a claim or respond to other pertinent communication within fifteen days;[346] the insurer also has fifteen days to commence any investigation.[347] We suggest that "fair and equitable" should be

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339 *See McCormick*, 475 S.E.2d at 519.

340 *Id.* (citing Jenkins v. J.C. Penney Casualty Ins. Co., 280 S.E.2d 252, 260 (W. Va. 1981)).

341 *Jenkins*, 280 S.E.2d at 259.

342 *See* Thomas v. State Farm Mut. Auto Ins. Co. 383 S.E.2d 786 (W. Va. 1989); W. VA CODE § 56-3-31 (1997).

343 W. VA. CODE § 33-11-4(9) (1996).

344 W. VA. CODE § 33-11-4(9)(f) (1996) (emphasis added).

345 *See* discussion *infra* note 390 and accompanying text (*Part VII Questions and Answers and the Future).*

346 *See* W. VA. CODE STATE R. tit. 114 § 114-14-5 (5.1) (1987); *see also* discussion *infra* note 390 and accompanying text (*Part VII Questions and Answers and the Future).*

347 *See* W. VA. CODE STATE R. tit. 114 § 114-14-5 (5.2) (1987); *see also* discussion *infra* note 390

given a marketplace-type definition. Much as a fair and equitable price for a house is whatever a willing buyer would pay a willing seller, a fair and equitable settlement is what a reasonable insured would accept from a reasonable insurer.[348] We suggest that liability is "reasonably clear" when "a reasonable person, with knowledge of the relevant facts and law, would probably have concluded, for good reason, that the insurer was liable to the plaintiff."[349]

Several West Virginia cases illustrate causes of action under W. Va. Code section 33-11-4(9). In *Thompson v. W. Va. Essential Property Insurance,* the insurer violated subparagraph (e), "[f]ailing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed,"[350] because it delayed payment by improperly claiming that the insured was a "prime suspect" in the fire loss.[351] In *Romano v. New England Mutual Life Insurance Co.,*[352] the insurer violated subparagraphs (d), "[r]efusing to pay claims without conducting a reasonable investigation based upon all available information;" and (f) "[n]ot attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear."[353] It improperly denied coverage under a group life insurance policy.[354] In *Maher v. Continental Casualty Co.* the insurer violated subparagraph (g), "[c]ompelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when such insureds have made claims for amounts reasonably similar to the amounts ultimately recovered[.]"[355] This sequential step is easy to show. The insured will fit the insurer's misconduct to one of the fifteen proscriptions in the statute.

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and accompanying text (*Part VII Questions and Answers and the Future).*

348 *See* discussion *infra* note 390 and accompanying text (*Part VII Questions and Answers and the Future).*

349 Demeo v. State Farm Mut. Auto Ins. Co., 649 N.E.2d 803, 804 (Mass. App. Ct. 1995); *see* discussion *infra* note 390 and accompanying text (*Part VII Questions and Answers and the Future).*

350 W. VA. CODE § 33-11-4(9)(e) (1996).

351 *See* Thompson v. W. Va. Essential Property Insurance, 411 S.E.2d 27, 29 (W. Va. 1991), *overruled on other grounds by* State *ex rel.* State Farm Fire & Cas, Co. v. Madden 452 S.E.2d 721 (W. Va. 1994) *as explained in* Light v. Allstate Ins. Co. No. 24365 (W. Va. July 7, 1998).

352 362 S.E.2d 334 (W. Va. 1987).

353 W. VA. CODE § 33-11-4(9) (d) and (f) (1996); *see* Romano v. New England Mut. Life Ins. Co., 362 S.E.2d 334 (W. Va. 1987).

354 *Romano,* 362 S.E.2d at 335 Syl. Pt. 3 (establishing the rule that "[w]here an insurer provides sales or promotional materials to an insured under a group insurance policy, which the insurer knows or should know will be relied upon by the insured, any conflict between such materials and the master policy will be resolved in favor of the insured.")

355 Maher v. Continental Casualty Co., 76 F.3d 535, 543 (4th Cir. 1996) (citing W. VA. CODE § 33-11-4(9)(g) (1996)).

C. *Sequential Step Three: Frequency as to Indicate a General Business Practice*

The third step is to show that the insurance company's violations were of such frequency as to indicate a "general business practice."[356] Here, the court has given guidance in three important cases. In *Jenkins*, the court held that the magic words "frequency as to indicate a general business practice" required that the plaintiff show that the insurer had violated the statute in several cases in the past.[357] A more recent indication of its meaning was in the case of *McCormick v. Allstate Insurance Co.*[358] There, the court said the following of general business practices:

> We conceive that proof of several breaches by an insurance company of W. Va. Code [section] 33-11-4(9), would be sufficient to establish the indication of a general business practice. It is possible that multiple violations of W. Va. Code [section] 33-11-4(9), occurring in the same claim would be sufficient, since the term "frequency" in the statute must relate not only to repetition of the same violation but to the occurrence of different violations. Proof of other violations by the same insurance company to establish the frequency issue can be obtained from other claimants and attorneys who have dealt with such company and its claims agents, or from any person who is familiar with the company's general business practice in regard to claim settlement.[359]

This means that a plaintiff needs to show that the insurer violated the statute in multiple cases in the past, or violated the statute on multiple occasions within the plaintiff's claim. Finally, in *Dodrill v. Nationwide Mut. Ins. Co.*, the court held that several violations of several different sub-paragraphs, or a series of separate and discrete violations of a single subsection will prove "general business practice."[360] It therefore must be shown that either the company frequently violated the statute in past claims, or the company violated the statute several times within a particular claim.

At trial, the plaintiff-insured might try several methods to prove frequency. First, the insured will testify as to facts that tend to show multiple violations of subsection (9). Second, the plaintiff will want to examine the claims adjuster, who will testify as to facts about the claim and possibly show violations of subsection

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356 W. VA. CODE § 33-11-4(9) (1996); *see also McCormick*, 475 S.E.2d at 519.

357 *See Jenkins*, 280 S.E.2d at 260.

358 475 S.E.2d 507 (W. Va. 1996).

359 *McCormick*, 475 S.E.2d at 519 (quoting *Jenkins*, 280 S.E.2d at 260).

360 Dodrill v. Nationwide Mut. Ins. Co, 491 S.E.2d 1, 10 (W. Va. 1996).

(9). Third, the plaintiff might also call other attorneys to testify as to previous violations of the Act in cases that they have brought against the company. In fact, the West Virginia Trial Lawyers Association keeps a list of winning cases against insurance companies, which future attorneys may use to locate potential attorney witnesses. Fourth, the plaintiff may even call other claimants from these past cases, although most plaintiffs prefer not to use them because they are unskilled witnesses. Fifth, plaintiffs will also hire insurance experts to testify that certain actions constitute violations of the Act. Sixth, the plaintiff might call an agent from the office of the West Virginia State Insurance Commissioner who will have written records of complaints filed with the office against an insurance company. Finally, the plaintiff might call anyone else familiar with the practices of an insurance company, for example, former agents of the company.

The plaintiff is now entitled to damages for aggravation and inconvenience, emotional distress, anger, anguish, depression, disappointment, embarrassment, fear, fright, grief, horror, humiliation, shame, worry, attorney's fees and costs,[361] excess over policy proceeds, expenses, loss of consortium, and net economic loss.[362]

D. Sequential Step Four: Actual Malice

The fourth sequential step in a claim under West Virginia Code section 33-11-4(9) is to show that the defendant acted with actual malice. This is a question of fact.[363] Actual malice means that "the insurance company actually knew that the policyholder's claim was proper, but willfully, maliciously and intentionally utilized an unfair business practice in settling, or failing to settle, the insured's claim."[364] This is a tough standard. A plaintiff will rarely be able to prove this step, but if the plaintiff does so prove, punitive damages will be awarded.[365]

VI. OTHER ISSUES RELATED TO RECOVERY

A. Bifurcation and The Big Trial Mess

All four sequential steps should be tried in one trial, and the trial should not be bifurcated.[366] The different steps are then dealt with in the instructions to the

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361 Note that attorney fees and costs must be awarded by the court through a post-trial motion and are not awarded by the jury. *See* discussion *infra* Part VI.B.

362 *Thompson*, 411 S.E.2d at 35.

363 *See generally McCormick*, 475 S.E.2d at 510 Syl. Pt. 8.

364 *Id.* at 509 Syl. Pt. 2.

365 *Id.*

366 *See Thompson*, 411 S.E.2d at 35 (holding that a cause of action under the Unfair Claims Settlement Practice Act is premature when the underlying policy claim has not been resolved). *Compare*

jury, who are told what they must find in order to award damages associated with each sequential step. Juries are generally instructed as to the elements and damages as described in this article. However, the verdict forms do not usually separate the different sequential steps and the elements and damages that follow. Rather, the jury is instructed as to the law, and then their award of damages on the jury verdict form indicates that all of the necessary elements were met. Rule 42(c) of the West Virginia Rules of Civil Procedure allows the court to bifurcate under some circumstances.[367] Bifurcation, rarely happens, however, because "unitary trials promote efficiency and serve the interest of justice by avoiding the scandal and inequity of inconsistency."[368] Thus, in 1998, the West Virginia Supreme Court of Appeals held that:

> in a first-party bad faith action against an insurer, bifurcation and stay of the bad faith claim from the underlying action are not mandatory. Under Rule 42(c) of the West Virginia Rules of Civil Procedure, a trial court, in furtherance of convenience, economy, or to avoid prejudice, may bifurcate and stay a first-party bad faith cause of action against an insurer.[369]

Courts should consider several factors in deciding whether to bifurcate, including the number of parties in the case; the complexity of the underlying case against the insurer; whether undue prejudice would result to the insured if discovery is stayed; whether a single jury will ultimately hear both bifurcated cases; whether partial discovery is feasible on the bad faith claim; and the burden placed on the trial court by imposing a stay on discovery.[370]

B. Attorney's Fees and Costs — Not for the Jury

If the jury finds that the defendant insurance company acted with such frequency as to indicate a general business practice, then the plaintiff is entitled to recover attorney's fees and costs. The jury does not award these damages. The

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McCormick, 475 S.E.2d at 519 (holding that the *Thompson* ruling makes it clear that the trial should not be bifurcated, and that the resolution of the underlying policy claim must be made during the single trial (on all sequential steps) in order for the jury to award damages for violation of the Act).

367 W. VA. R. CIV. P. 42(c):
Separate Trials.--The court, in furtherance of convenience or to avoid prejudice, or when separate trials will be conducive to expedition and economy, may order a separate trial of any claim, cross-claim, counterclaim, or third-party claim, or of any separate issue or of any number of claims, cross-claims, counterclaims, third-party claims, or issues, always preserving inviolate the right of trial by jury as declared by Article III, Section 13 of the West Virginia Constitution or as given by a statute of this State.

368 State *ex rel.* Cavender v. McCarty, 479 S.E.2d 887, 894 (W. Va. 1996).

369 Light v. Allstate Insurance Company, 1998WL381663, Syl. Pt. 2 (W. Va. 1998).

370 *Id.* at Syl. Pt. 3.

plaintiff's attorney must make a post-trial motion for a hearing on attorney's fees and costs at which time the plaintiff's attorney will present the analysis of fees and costs. The judge then makes a determination of how much, if any, of the attorney's fees and costs will be charged to the defendant insurance company. Two different approaches have been taken in West Virginia insurance misconduct cases regarding the proper amount of attorney's fees to be awarded. In *Hayseeds v. State Farm Fire & Cas.*, the court held that attorney's fees should be equal to one-third of the face amount of the policy, where the policy is not extremely large or extremely small.[371] This result is based on the typical contingency fee arrangement.[372] The second view taken by the court was in *Landmark Baptist Church v. The Brotherhood Mut. Ins. Co.*.[373] In that case, the court held that

> [t]he reasonableness of attorney's fees is generally based on broader factors such as: (1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the undesirability of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases.[374]

Thus, in this second case, attorney's fees are not based on a mathematical formula as in *Hayseeds*; instead, the judge has discretion to determine what fees would be reasonable. We suggest that the approach in *Landmark Baptist Church* is preferable because a mathematical formula based on policy amounts does not take into account important factors such as the amount of extra time that the plaintiff's attorney had to spend because of intentional delays by the defendant, and how much time and money that plaintiff had to expend before bringing suit trying to make the defendant honor its policy. An approach based on reasonableness is arguably the more reasonable approach.

C. *Common Law and Statutory Theories Asserted Together*

Both common law and statutory theories are always asserted together by filing a two-count complaint. Although the plaintiff may not recover double

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371 Hayseeds v. State Farm Fire & Cas., 352 S.E.2d 73, 80 (W. Va. 1986).

372 *Id.*

373 484 S.E.2d 195 (W. Va. 1997).

374 *Id.* at 198.

damages, asserting both theories may make recovery for aggravation, inconvenience, attorney's fees, and costs easier. To illustrate, even if a plaintiff does not substantially prevail on the underlying claim, which is required to recover aggravation and inconvenience and attorney's fees under a common law theory, the plaintiff might be able to recover these damages by showing that the company had committed statutory violations with such frequency as to indicate a general business practice.

Unfortunately, bringing concurrent causes of action for common law bad faith and statutory misconduct has led to a great deal of confusion. For example, in *McCormick v. Allstate Ins. Co.*, the trial judge ordered that the trial be bifurcated.[375] The issue of violation of common law duty of good faith was to be tried first. Then, the statutory frequency step was to be tried, if necessary, along with the common law elements of substantially prevailed and actual malice.[376] At the end of the first phase, the amount that the jury found for the plaintiff was less than what the plaintiff had initially demanded. The judge held that because the plaintiff had not substantially prevailed, he could not go forward with the second phase of trial.[377] On appeal, the Court cleared up the confusion. It explained that a plaintiff need not substantially prevail in order to bring a claim for an insurer's frequent violation of subsection (9).[378] To proceed to statutory sequential step three, the plaintiff need only show that the underlying claim was ultimately resolved.[379] One must be careful not to confuse the sequential steps of a common law claim for misconduct with the sequential steps of a statutory misconduct claim.

D. ERISA Preemption

There is one significant exception to the federal deference to state insurance laws. The preemption clause of the Employee Retirement Income Security Act of 1974 (ERISA) states that "[e]xcept as provided in subsection (b) of this section [the saving clause], the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan . . . ."[380] ERISA's saving clause, however, states that "[e]xcept as provided in subparagraph (B) [the deemer clause], nothing in this subchapter shall be construed to exempt or relieve any person from

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375 McCormick v. Allstate Ins. Co., 475 S.E.2d 507, 510 (W. Va. 1996).

376 *Id.* at 510.

377 *Id.*

378 *Id.* at 519.

379 *Id.* at 514-15.

380 Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 44-45 (1987) (quoting section 514(a) as set forth in 29 U.S.C. section 1144(a)).

any law of any state which regulates insurance, banking, or securities . . . ."[381] In other words, the preemption clause does not apply to preempt state insurance laws. In the deemer clause, however, the statute provides that

> [n]either an employee benefit plan . . . nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer . . . or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, [or] insurance contracts . . . .[382]

To summarize, if a state law relates to employee benefit plans, then it is preempted by ERISA. The saving clause, however, excepts laws that regulate insurance.[383] In *Dedeaux*, the U.S. Supreme Court held that suit by an employee against his employer's group insurance policy was preempted by ERISA.[384] In *Ball v. Life Planning Services, Inc.*,[385] the West Virginia Supreme Court held that a suit against an insurance broker for violation of the Unfair Claims Settlement Practices Act[386] was not preempted by ERISA.[387] Employee welfare benefit plans are exempt from statutory insurance misconduct suits but are liable under ERISA.[388]

E. Statute of Limitations

The statute of limitations for unfair claims settlement practices actions is one year.[389]

VII. QUESTIONS AND ANSWERS AND THE FUTURE

A. Definitions

One of the biggest problems facing a plaintiff bringing a claim for

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381 *Id.* at 45 (quoting §514(b)(2)(A) as set forth in 29 U.S.C. §1144(b)(2)(A)) (emphasis added).

382 *Id.* (quoting §514(b)(2)(B) as set forth in 29 U.S.C. § 1144(b)(2)(B)).

383 *See id.*

384 *Id.* at 57.

385 Ball v. Life Planning Services, Inc., 421 S.E.2d 223 (W. Va. 1992).

386 W. VA. CODE § 33-11-4(9) (1996).

387 *Ball*, 421 S.E.2d at 227.

388 *Id.* at 224-27. In *Ball*, the plaintiffs' alternative cause of action was not preempted by ERISA. In addition to a cause of action for unfair claim settlement practices, the plaintiffs brought suit for violation of W. Va. Code section 33-12-21. That code section imposes personal liability upon an agent or broker who is not licensed to transact insurance in West Virginia. *See id.*

389 *See* Wilt v. State Automobile Mut. Ins. Co., 506 S.E.2d 608, 614 (W. Va. 1998).

statutory misconduct is determining the meanings of various terms in the subparagraphs of West Virginia Code section 33-11-4(9).[390] The West Virginia Court has offered little insight into the meanings of many of the terms in the statute. Because plaintiffs most often allege violation of subparagraph (f),[391] it is worthwhile to try to interpret the meaning of some of its terms. Subparagraph (9) reads "[n]ot attempting in *good faith* to effectuate *prompt, fair and equitable* settlements of claims in which liability has become *reasonably clear*" is an unfair claims settlement practice.[392] The terms in bold are the most important terms for purposes of interpretation.

Definitions of good faith are hard to find. Three possible definitions of "good faith" are suggested. First, the Oklahoma state code offers a good definition of good faith: "[g]ood faith consists in an honest intention to abstain from taking any unconscientious advantage of another, even through the forms or technicalities of law, together with an absence of all information or belief of facts which would render the transaction unconscientious."[393] Second, in *Shamblin v. Nationwide Mut. Ins. Co.*, the West Virginia Supreme Court suggests that good faith has something to do with basing conduct on reasonable and substantial grounds, and according the interests and rights of the insured at least as great a respect as its (the insurer's) own.[394] Finally, good faith means that an insurer did not act unreasonably by failing to compensate the insured, without proper cause, for a loss covered by the policy. If coverage is fairly debatable and the insurer denies coverage, then it is not bad faith.[395]

"Prompt" should be defined by the state insurance regulations. Under the regulations, an insurer must acknowledge the receipt of a notification of a claim or respond to other pertinent communication within fifteen days; the insurer also has fifteen days to commence any investigation.[396] "Fair and equitable" should be given a marketplace-type definition. As much as a fair and equitable price for a house is whatever a willing buyer would pay a willing seller, a fair and equitable settlement is what a reasonable insured would accept from a reasonable insurer.

The other significant term not defined by statutes, regulations, or the court is when does liability become "reasonably clear." However, Massachusetts has suggested two particularly compelling definitions. First, one court suggested that liability is "reasonably clear" if the company "knew . . . that there was 'a reasonable likelihood that a jury would return a verdict in favor of the defendants at

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390 W. VA. CODE § 33-11-4(9) (1996).

391 W. VA. CODE § 33-11-4(9)(f) (1996).

392 W. VA. CODE § 33-11-4(9)(f) (1996) (emphasis added).

393 OKLA. STAT. 25, §9(1987).

394 Shamblin v. Nationwide Mut. Ins. Co., 396 S.E.2d 766, 769 (W. Va. 1990).

395 *See* SHERNOFF, *supra* note 228, at §5.02[2].

396 W. VA. CODE STATE R. tit. 114 § 114-14-7 (1987).

trial.'"[397] This definition may be too speculative, and the use of jury prediction may make some lawyers uncomfortable. Thus, a second possible definition may be offered whereby liability is defined as "reasonably clear" when "a reasonable person, with knowledge of the relevant facts and law, would probably have concluded, for good reason, that the insurer was liable to the plaintiff."[398] Although these definitions do not shed a bright light of clarity on the meaning of the West Virginia statutes, they offer a possible guideline for a plaintiff who is in the dark. In any case, the meaning of the terms remains a semantic mystery to the trier of bad faith claims.

B. The Future of The Act

The future of the West Virginia law of statutory misconduct should be one free of confusion, whereby the intricacies of the law are further explained and evaluated with each case the West Virginia Supreme Court hears. In addition, the language of West Virginia Code section 33-11-4(9) may be rewritten to be more liberal, because the model act promulgated by the NAIC has been amended by the NAIC since it was adopted by the West Virginia Legislature. The most significant change is that the initial language adds, as an alternative to proving that the insurance company has acted with such frequency as to indicate a general business practice, that the action be "committed flagrantly and in conscious disregard of this Act or any rules promulgated hereunder."[399] An insured would no longer have to prove multiple violations of the Act in order to assert a cause of action. The insured would need to prove only that there was one violation that was committed flagrantly and in conscious disregard of the Act. So far, only Georgia, Missouri, and Nebraska have adopted the amended 1990 model.[400] However, other states that have adopted a version of the Act could still enact the new version in the future. The new version is more consistent with public policy. Under the present version of the Act, if an insurance company committed a flagrant violation of the Act with respect to one of its insureds, but it was the first time that the company committed such a violation, and it violated only one of the subparagraphs of the Act, then the insured could not recover under sequential step three of a cause of action for statutory misconduct under the Act.

PART III: THIRD PARTY COMMON LAW BAD FAITH

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397 Van Dyke v. St. Paul Fire and Marine Ins. Co., 448 N.E.2d 357, 361 (Mass. 1983).

398 Demeo v. State Farm Mut. Auto. Ins. Co., 649 N.E.2d 803, 804 (Mass. App. Ct. 1995).

399 *See* SHERNOFF, *supra* note 228, §§ 6-56 to 6-59.

400 *Id.*

I. INTRODUCTION

Insurance bad faith law began in the third party context. Third party bad faith law applies when there is misconduct on the part of the insurer in handling a claim by a third party claimant against the policy holder. The common law of third party bad faith blossomed in its current form in California in the 1950s and 1960s. Although the West Virginia Supreme Court of Appeals could have developed its law in this area in the 1960s, this state failed to develop its law until 1990. Since then, the court has attempted to shape the law in several cases, but many areas of third party insurance bad faith law still remain unclear. This section will present the history and national norms of third party bad faith common law and will address the current state of the law. Lastly, this section will discuss some of the more important issues of third party bad faith law that remain unclear or undecided.

II. HISTORY

A. National

Bad faith insurance litigation is a relatively recent development in the common law. It was generated in response to the inadequacies of contract law in dealing with the insurer's breach of the duty to the insured. Prior to the cause of action for bad faith, insurance companies acted without risk of having to pay anything but the policy limits.[401] For example, if the insurance company failed to settle within the limits, the burden of paying the excess verdict fell on the insured, not on the insurer. This result followed the common law rule of contract damages set forth in *Hadley v. Baxendale*,[402] that the only damages recoverable were those that arose out of the breach itself or those that could be contemplated by the parties when they entered into the contract.[403] In such a system, the capacity for abuse by the insurer was immeasurable.

Courts began to recognize the harm caused by unfair settlement practices in the 1930s and 1940s, and in response began to develop a tort law alternative to the inadequate contract remedies.[404] The rationale used to justify the use of tort

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401 STEPHEN S. ASHLEY, BAD FAITH ACTIONS §1:01 (1997).

402 156 Eng.Rep. 145 (Ex. 1854).

403 *See id.* at 151.

404 *See* ASHLEY, *supra* note 401, at §1:01 (recognizing the increasing number of automobile claims). *See also* Michael Sean Quinn, *Insurance Bad Faith, Sic et Non, Texas Style*, INSURANCE LITIGATION REPORTER, 485 (August 15, 1997). Quinn states four reasons that state courts found contract law to be insufficient for controlling insurer conduct:

> First and foremost, states were struck by the asymmetry of the wealth and power which usually obtains between insurers and insureds. . . . Second, contract disputes are subject to many technical defenses. The courts wanted to utilize the simpler and more flexible

remedies in insurance coverage cases was the special nature of the relationship between the parties to an insurance contract. Four specific aspects of the insurance contract were frequently stated: (1) insurance contracts are considered contracts of adhesion; (2) there is often a lack of equality in bargaining power between the parties; (3) the insurance industry is one of quasi-public business nature; and (4) the industry gives the insured peace of mind and protection against catastrophic personal and economic loss.[405]

To establish a tort cause of action for bad faith, the court used the implied duty of good faith and fair dealing. This duty is implied in every contract and is stated in the *Restatement 2d of Contracts*: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."[406] The implied duty of good faith and fair dealing developed in contract law dealing with subjective satisfaction of a contracting party. This duty was first imposed primarily in situations in which one party was placed by the contract in a position to affect substantially the other party's right to receive the benefits of the contract. *Brassil v. Maryland Cas. Co.* was one of the earliest cases to expressly state that the duty of good faith and fair dealing was owed by the insurer to the insured.[407] The plaintiff in *Brassil* was allowed to recover the expenses of appealing a judgment against the insured after the insurer refused to prosecute the appeal.[408] The court in *Brassil* held that the rights of the insured "go deeper than the mere surface of the contract written for him by the [insurer]. Its stipulations imposed obligations based upon those principles of fair dealing which enter into every contract."[409]

It was only natural for the courts to extend the duty of good faith and fair dealing to insurance policies because of the fiduciary relationship that exists between the insurer and insured.[410] The rationale for implying the duty was that the insurer had absolute control over the conduct of the litigation and could reject policy limit settlement offers in hopes of negotiating a better deal, without worry

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> tort law to regulate insurer conduct. . . . Third, oracles of the law, including great and distinguished judges such as Oliver Wendell Holmes, legal scholars, and law professors who indoctrinate the young, have for many years taught that it is not in-and-of-itself morally impermissible to breach a contract. Rather, the oracles have taught that contract violation is either morally neutral, or even to be encouraged when it is economically efficient. . . . Fourth, consequential damages are much harder to prove than regular damages, and there are severe restrictions as to which damages actually count as consequential.

Id. at 487-88.

405 *See* SHERNOFF, *supra* note 228, at §1.02.

406 RESTATEMENT (SECOND) OF CONTRACTS §205 (1979).

407 104 N.E. 622 (N.Y. 1914).

408 *See id.* at 624.

409 *Id.*

410 *See* SHERNOFF, *supra* note 228, at §1.07[2].

that they would have to pay any more than the policy limits.[411] The implied covenant of good faith gave courts the broader range of tort remedies to apply when insurers mistreated their insured.[412] In crafting the rules for bad faith, the early court decisions established liability based either on the insurer's negligent handling of the case[413] or on its acting in bad faith.[414] However, the different standards amounted to the same thing and usually reached uniform results.[415]

After *Brassil*[416] in 1914, the implied covenant of good faith and fair dealing remained dormant in the insurance context until 1931 when the Wisconsin Supreme Court reasserted the concept in *Hilker v. Western Auto. Ins. Co.*.[417] *Hilker* involved an action for bad faith failure to settle within the policy limits, and the insured attempted to recover the amount of the excess judgment.[418] The court took note of the explosion of litigation surrounding automobile accidents and recognized a problem where the insurer had complete control over the litigation process.[419] The court recognized the logic in *Brassil* and quoted in its holding that "the rights of the insured go deeper than the mere surface of the contract."[420] The court implied the duty of good faith because the insured bargains away all of his rights to settle and defend.[421] The court concluded that the duty of good faith would be met if the insurer acted as a reasonably prudent person exercising ordinary care would act.[422]

The duty of good faith and fair dealing assumed the important role it maintains in insurer/insured relations today in a series of California cases. In *Brown v. Guarantee Ins.Co.*,[423] an intermediate appellate court recognized that good faith was the best description of the insurer's duty to the insured when it undertakes to defend the insured against the claims of a third party claimant.[424] One year later, the tort was firmly established by the California Supreme Court's decision in

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411 *See id.*

412 *See id.*

413 *See* ASHLEY, *supra* note 401, at §2:04.

414 *See id.* at §2:05.

415 *See id.* at §2:06.

416 104 N.E. 622 (N.Y. 1914).

417 231 N.W. 257 (Wis. 1930).

418 *See id.* at 258.

419 *See id.*

420 *Id.*

421 *See id.* at 261.

422 *Hilker*, 231 N.W. at 257 Syl. Pt. 4.

423 319 P.2d 69 (Cal. Ct. App. 1957).

424 *See id.*

Comunale v. Traders & Gen. Ins.Co.[425] In *Comunale*, the California Supreme Court stretched to come up with a new cause of action in order to save the plaintiff's case. The plaintiff filed his cause of action after the expiration of the statute of limitations for tort, but within that provided for contracts.[426] Recognizing that the implied covenant of good faith and fair dealing exists in every contract, the California Supreme Court held that a bad faith action not only is in the nature of a tort, but also includes aspects of contract law and may be brought under either theory.[427]

Thus with *Brassil*[428] and *Hilker*[429] as a background, *Comunale*[430] set in motion the current law of bad faith insurance litigation by firmly establishing an independent cause of action when an insurer violates its implied duty under the insurance contract to act in good faith. Since *Comunale*,[431] virtually all states have followed California's lead and have recognized the tort of bad faith in third party insurance cases. "The mandates of these courts is clear: bad faith conduct and unreasonable claims practices by the insurance industry will not be tolerated."[432]

B. West Virginia

Less than ten years after the California Supreme Court's decision in *Comunale*, West Virginia had the opportunity to follow California's lead by adopting the tort of bad faith and begin defining its parameters. The West Virginia Supreme Court failed to take advantage of the opportunity. As a result, West Virginia lawyers, judges, and litigants wallowed in the uncertainty of the tort's future in the state for nearly twenty-five years.

1. *Speicher v. State Farm Mutual Automobile Insurance Company*

In 1966 in *Speicher*,[433] the West Virginia Supreme Court of Appeals was asked to instruct the bench and bar about third party bad faith in West Virginia. In *Speicher*, an insurer appealed a judgment for the insured awarding the amount of

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425 328 P.2d 198 (Cal. 1958).

426 *See id.* at 203.

427 *See id.*

428 104 N.E. 622 (N.Y. 1914).

429 231 N.W. 257 (Wis. 1930).

430 328 P.2d 198.

431 *See id.*

432 SHERNOFF, *supra* note 228, at §1:08.

433 Speicher v. State Farm Mut. Auto. Ins. Co., 151 S.E.2d 684 (W. Va. 1966).

the plaintiff's excess verdict in the underlying case.[434] The court recognized the need to educate the bench and bar as to the existence of the cause of action for bad faith in West Virginia and the appropriate standard to be applied. However, the court failed to so educate, and instead avoided the issue. Without expressly recognizing the third party bad faith cause of action, the court stated that "[s]ince it is the opinion of this Court . . . that the [insurer] was guilty of neither negligence nor bad faith, it will not be necessary . . . to go into detail in this opinion in attempting to distinguish between them."[435]

2. Richard E. Rowe: Insurance - Recovery of Excess Judgment from Insurance Company[436]

The next step in the history of third party bad faith in West Virginia came in the form of a student article in the West Virginia Law Review written by Richard Edwin Rowe[437] in the wake of *Speicher*.[438] Rowe predicted that the bad faith cause of action would be recognized and that a good faith as opposed to negligence standard would be applied.[439] Rowe referred to a Virginia malpractice case that had recently adopted the good faith standard instead of negligence.[440] Rowe also found support for his prediction in a federal Southern District of West Virginia case that decided an excess judgment case applying a "good faith" standard.[441] Rowe also claimed that the West Virginia Vehicle Safety Responsibility Law was pertinent for its statement that an insurance company "can discharge its legal obligations for the amount of the policy covered by the act by a *good faith settlement*."[442] Rowe concluded that

> [s]ince the Virginia court and the District Court for the Southern District of West Virginia, along with the West Virginia Legislature in the Safety Responsibility Law have all endorsed the

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434 *Id.* at 685 (the policy limits were $10,000.00, and the jury returned a verdict against the Speichers for $16,000.00).

435 *Id.*

436 Richard E. Rowe, Comment, *Insurance - Recovery of Excess Judgment from Insurance Company*, 70 W. VA. L. REV. 98 (1968).

437 *Id.*

438 151 S.E.2d 684.

439 Rowe, *supra* note 436, at 103.

440 *Id.* at 102 (citing Aetna Cas. and Sur. Co. v. Price, 146 S.E.2d 220 (Va. 1966); Rowe admitted that the Virginia case involved a malpractice claim, but the Virginia Court had used an automobile insurance case as authority).

441 *See id.*(citing Inland Mut Ins. Co. v. Peerless Ins. Co., 152 F. Supp. 506 (S.D.W.Va. 1957).

442 *Id.* at 102 (emphasis in original).

> "good faith" rule, it is most likely that when the West Virginia Supreme Court of Appeal is confronted with the question they will follow the majority and require that refusal to settle be a "good faith" refusal.[443]

3. *Daniels v. Horace Mann Mutual Insurance Company*

Three years later, the Fourth Circuit was faced with the issue in an excess verdict/failure to settle case arising out of the Southern District of West Virginia.[444] The Fourth Circuit recognized in this diversity case that it was bound by West Virginia law.[445] Because no decision on the issue existed in West Virginia, the Fourth Circuit was forced to make an "*Erie* educated guess."[446] The district court believed that West Virginia would adopt a good faith standard and ruled in favor of the insurer.[447] The Fourth Circuit reversed and ordered final judgment for the plaintiffs in the amount of the excess verdict.[448]

In reaching its decision, the Fourth Circuit referred to its previous decision in *American Cas. Co. Of Reading, Pa. v. Howard*[449] in which the court applied South Carolina law. Quoting *Howard,* the Court held that "if the insurer acted reasonably, in good faith and without negligence in refusing proffered settlements' it met its obligations to the insured. This pronouncement is our text for decision presently. It provides an understandable and a workable formula."[450] Ruling that the insurance company was guilty of bad faith, the Fourth Circuit detailed the insured's acts of bad faith and summarized them as follows:

> (a) there was only a superficial investigation; (b) there was no serious attempt to settle; (c) the company did not accept the recommendations of its counsel and agents as to the amount it should offer in settlement of the case; (d) there was only scanty consideration given to the insured's predicament; and (e) there was neglect in appraising the danger of the outstanding

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443 *Id.* at 103 (citations omitted).

444 Daniels v. Horace Mann Mut. Ins. Co., 422 F.2d 87 (4th Cir. 1970).

445 *See id.* at 88.

446 *See id.*

447 *See id.*

448 *Id.* at 90.

449 187 F.2d 329 (4th Cir. 1951).

450 *Daniels*, 422 F.2d at 89.

was required to pay a punitive damage award against the insured as well as the amount of the compensatory damages in an excess judgment over the insurance coverage available.[462] The third party claimants were injured when the insured collided head on with their car.[463] At the time of the collision, the insured was drunk and speeding.[464] The insurance company refused to settle for the $10,000/$20,000 policy limits.[465] This lawsuit was brought directly by the third party claimants.[466] The jury returned a verdict for both plaintiffs in excess of the limits and with punitive damages as well.[467] The court concluded that under the broad language of the policy, an insurer is responsible for indemnifying the insured for punitive damages awards so long as the insured's actions were not intentional but remained in the gray area of gross, reckless, or wanton.[468] Before the court answered this question, it assumed that bad faith liability existed and that the third party could sue the insurer directly for a wrongful failure to settle within policy limits.[469] This decision will be discussed more fully in sections IV and VI.

6. *Shamblin v. Nationwide Mutual Insurance Company*

In 1990, the *Shamblin* decision for the first time expressly recognized the cause of action for third party insurance bad faith in West Virginia.[470] The decision also set forth the standard to be applied.[471] After *Shamblin*, an insurance company may be liable for extra contractual damages if it handles a claim in such a manner as to violate its implied duty of good faith and fair dealing.[472] If the plaintiff can prove a violation of this duty, the insurer is then faced with the heavy burden of showing, by clear and convincing evidence, that it acted in good faith.[473] The law as established in *Shamblin*[474] will be discussed fully in Section V.

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462 *See id* at 228.

463 *See id.*

464 *See id.*

465 *See id.*

466 *See Hensley*, 283 S.E.2d at 228.

467 *See id.*

468 *See id.* at 230.

469 *See id.* at 228 n.1.

470 *See* Shamblin v. Nationwide Mut. Ins. Co., 396 S.E.2d 766, 768 (W. Va. 1990).

471 *See id.* at 776.

472 *See id.*

473 *See id.*

474 *See id.*

determination of liability.[451]

Thus, the Fourth Circuit predicted that the cause of action for bad faith would be adopted in West Virginia.

4. *Vencill v. Continental Casualty Company*

In 1977, the issue arose again in the Southern District of West Virginia, this time in the context of a dispute between a primary and excess insurance carrier.[452] In the underlying case, there was a dispute as to the exact amount of coverage provided by the primary policy.[453] Upon an excess verdict against the insured, the primary insurer paid what it felt were the policy limits, and the excess insurer refused to pay at all.[454] According to the excess carrier, the primary limits had not been exhausted.[455] The insured and the third party plaintiffs sued both insurers who filed cross claims against each other.[456] The insurers settled with the plaintiffs, and the case proceeded on the issue of the primary insurer's duty to the excess carrier and the true amount of the primary insurance policy limits.[457]

First, the court ruled that the duty owed to the excess carrier by the primary insurer was identical to that owed to the insured: "to act in good faith and without negligence in the settlement of claims within the policy limits . . . ."[458] Again recognizing that the issue was unsettled in West Virginia, the District Court applied the Fourth Circuit test as stated in *Daniels*[459] and found that the primary insurer "acted neither reasonably nor in good faith, nor without negligence, in attempting to settle the claims."[460]

5. *Hensley v. Erie Insurance Company*

The first suggestion of a third party bad faith cause of action came in *Hensley*.[461] The primary question in *Hensley* was whether an insurance company

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451 *Id.* at 90.

452 Vencill v. Continental Cas. Co., 433 F. Supp. 1371 (S.D.W.Va. 1977).

453 *See id.* at 1373.

454 *See id.*

455 *See id.* at 1375-76.

456 *See id.* at 1376.

457 *See Vencill*, 433 F. Supp. at 1376.

458 *Id.*

459 422 F.2d 87 (4th Cir. 1970).

460 *Vencill*, 433 F. Supp. at 1377.

461 Hensley v. Erie Ins. Co., 283 S.E.2d 227 (W. Va. 1981).

III. NATIONAL LAW NORMS

The national norm for liability in third party bad faith cases is one of good faith and fair dealing. It is understood that neither party will do anything to harm the other party to the contract. In the two decades since *Comunale*, the cause of action for the tort of bad faith has expanded throughout the country. Courts differ in this area of law on what actions will constitute a breach of the duty of good faith and fair dealing and on what standard should be applied to ascertain the existence of a breach of the duty of good faith and fair dealing. This subsection discusses the prevalent standards that have been adopted in jurisdictions throughout the United States.

A. Factors Test

An early approach in deciding what constituted bad faith in failing to settle within policy limits is known as the factors test. This test entailed the court's delineation of a variety of factors to consider in determining whether the insurer refused to settle in good faith. An example from an early California case states the test as follows:

> In deciding whether the insurer's refusal to settle constitutes a breach of its duty to exercise good faith, the following factors should be considered: [1] the strength of the insured claimant's case on the issues of liability and damages; [2] attempts by the insurer to induce the insured to contribute to a settlement; [3] failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; [4] the insurer's rejection of advice of its own attorney or agent; [5] failure of the insurer to inform the insured of a compromise offer; [6] the amount of financial risk to which the party is exposed in the event of a refusal to settle; [7] the fault of the insured in inducing the insurer's rejection of the compromise offer by misleading it as to the facts; [8] and any other factors tending to establish or negate bad faith on the part of the insurer.[475]

The factors test has proved an impracticable guide for insurers deciding whether or not to reject the policy limits settlement offer.

B. Equality of Interests Test

The equality of interests test defines the insurer's duty in considering whether to reject a settlement offer that is within policy limits, as a requirement that

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475 Brown v. Guarantee Ins. Co., 155 Cal.App.2d 679, 689, 319 P.2d 69, 75 (Cal. 1957).

the insurer give the insured's interests at least the same amount of consideration as it gives its own interests. Although the thought of this "egalitarian" approach is reassuring, it too has proved difficult in application by courts and insurance companies. The New Jersey Supreme Court highlighted the fundamental flaw in the equal consideration standard:

> Yet however much the carrier considers the interests of its insured in pondering the decision as to settlement, the moment it decides not to settle, it in effect, however reasonably, sacrifices the interests of the insured in order to promote its own. It is always to the benefit of the insured to settle and thereby avoid the danger of an excess verdict. Since as insurer serves only its own interests by declining to compromise within the insurance coverage, a decision not to settle is perforce a selfish one.[476]

It is, therefore, apparently impossible for an insurer to make a decision without violating this test.

C. *Disregard the Limits Rule*

In 1954, Professor Keeton proposed a modification of the equality of interests test. The underlying idea of that modification was that "the equality referred to is not equality weight in determination of the choice, but equality in consideration — that is, *consideration of each portion of the total risk without regard to who is bearing that portion of the risk.*"[477] The insurance company must make its decision as if there were no policy limit applicable to the claim. The theory behind the proposal was that it would remove the insurance company's institutional considerations from its decision making process.[478] Keeton's proposal was that the disregard the limits test was not new law, but merely an explanation of the disregard the limits test.[479] Although several states have utilized its language, this test also has its critics.[480]

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476 ASHLEY, *supra* note 401, at §3:18 (quoting Rova Farms Resort, Inc. v. Investors Ins. Co. of Am., 65 N.J. 474, 323 A.2d 495 (1974)).

477 *Id.* at §3:19 (quoting Robert E. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1146 (1954)(emphasis supplied by Ashley)).

478 *See id.*

479 *See id.*

480 According to the New Jersey Supreme Court in its *Rova Farms* decision:

> Even the rule requiring the carrier to form its judgment as though it alone were liable for the entire risk may be polluted by institutional considerations which ignore the interests of the specific insured involved . . . . These considerations may extend to a purpose to keep future settlement costs down, to numb the public's claim-consciousness, to create a conservative image for the discouragement of future claimants or to establish favorable

D. *Probable Outcomes Test*

According to Stephen S. Ashley, a fourth standard developing out of California judges the insured's decision based on its evaluation of the possible outcome of the third party claimants case.[481] According to Ashley, the cases "imply that a prudent insurer, operating under a policy with no limits, would calculate the reasonable settlement value of a claim based on the expected cost of the claim in the eyes of a risk neutral decision-maker . . . . [b]y focusing on outcomes and probabilities, one excludes 'institutional considerations' from the equation."[482] According to this modified standard, to determine whether the insurer properly considered the possible outcomes without considering the policy limits, the claim handler should consider the following factors:

> (1) the legal facets of the case; (2) the probabilities of a verdict and its anticipated range if adverse; (3) the strengths and weaknesses of all the evidence; (4) the plaintiff's injury or harm; (5) the experience and capacity of counsel; (6) verdicts awarded in similar cases in the same jurisdiction; and (7) the relative appearance and likely appeal of the witnesses.[483]

IV. WEST VIRGINIA LAW OVERVIEW

A. *Hensley v. Erie Insurance Company*

West Virginia third party bad faith law begins with *Hensley v. Erie Insurance Co.*[484] Although the certified question before the court in *Hensley* was whether it would be improper to force an insurer to pay the punitive damages awarded against the insured,[485] the most important part of the decision for bad faith purposes was stated in the very beginning.[486] The court began by assuming that an insurer could be held liable for bad faith and that the injured third party could bring

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> precedents, none of which purposes has anything to do with the protection of the particular insured at hand . . . .

ASHLEY, *supra* note 401, at §3:20 (quoting *Rova Farms Resort, Inc.* at 508).

481 *Id.* at § 3:21 (the cases to which he refers are Isaacson v. California Ins. Guar. Ass'n, 44 Cal.3d 775, 750 P.2d 297, 244 Cal.Rptr. 322 (1988); Miller v. Elite Ins. Co., 100 Cal.App.3d 739, 161 Cal.Rptr 322 (1980); Merritt v. Reserve Ins. Co., 34 Cal.App.3d 858, 110 Cal.Rptr 511 (1973)).

482 *Id.*

483 *Id.*

484 283 S.E.2d 227 (W. Va. 1981).

485 *Id.* at 227-28.

486 *See id.*

a direct action against the defendant's insurance carrier.[487] The court praised the trial court in reaching this conclusion.

> The trial court, in a well-reasoned opinion, noted that this Court had not decided whether the plaintiff in a tort action could bring a direct suit against the defendant's insurance carrier for the excess damages recovered over the insurance limits. This type of excess is based on a claim that there was a wrongful failure to settle the case within the insurance limits.[488]

The stage was now set for *Shamblin*.[489]

B. *Shamblin v. Nationwide Mutual Insurance Company*

The West Virginia landmark third party common law bad faith decision came in *Shamblin v. Nationwide Mut. Ins. Co.*, where the court finally established the existence of the cause of action for bad faith in third party insurance situations.[490] *Shamblin* dealt with a dispute about the total policy limits available to the insured after an auto accident.[491] After the insurance company refused to settle a trial was held.[492] The liability jury returned a verdict in an amount that exceeded the policy limits by almost $600,000.00.[493] Shamblin sued his insurer for bad faith refusal to settle, and he sought to recover the amount of the excess verdict plus additional damages.[494] The court recognized this cause of action and discussed the standards to be applied to determine bad faith in the third party context.[495]

After *Shamblin*, whenever an insurer is afforded the opportunity to settle within policy limits and it fails to do so, thus exposing the insured to personal liability, "the insurer has prima facie failed to act in its insured's best interest and such failure to so settle prima facie constitutes bad faith . . . ."[496] Once a plaintiff has established a *prima facie* case of bad faith failure to settle, the insurance company must prove by clear and convincing evidence that it attempted to settle

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487 *See id.* at 228 n.1.

488 *Id.*

489 Shamblin v. Nationwide Mut. Ins. Co., 296 S.E.2d 766 (W. Va. 1990).

490 *Id.*

491 *See id.* at 769-70.

492 *See id.*

493 *See id.* at 771.

494 *See Shamblin*, 296 S.E.2d at 771.

495 *See id.* at 772-73.

496 *Id.* at 766 Syl. Pt. 2.

the case and that its failure to do so "was based on reasonable and substantial grounds, and that it accorded the interests and rights of the insured at least as great a respect as its own."[497] The *Shamblin* Court then set forth a nonexclusive list of factors to consider in deciding whether an insurer's decision to reject a policy limits settlement offer was reasonable.[498]

C. *State ex rel. Allstate Insurance Company v. Karl*

In *State ex rel. Allstate Ins. Co. v. Karl*,[499] the court held that an underinsured motorist insurance (UIM) carrier is analogous to an excess insurer, and the defendant's primary personal injury liability carrier owes the UIM carrier the duty of good faith in its defense of the claim.[500] In *Karl*, the plaintiff was injured when she was struck by a car driven by the defendant.[501] The plaintiff sued the defendant and provided the suit papers to her insurer, Allstate, in compliance with West Virginia's statutory provision concerning UIM coverage.[502] Both Allstate and the defendant's primary insurer answered and commenced discovery.[503] The court ordered the insurance companies to present a unified defense to be handled by the defendant's liability insurer.[504]

UIM coverage is analogous to that of excess coverage based on the language of the UM/UIM statute.[505] Because the primary liability lies with the defendant's primary insurer, that company has the responsibility of defense, but in such defense, it owes the UIM carrier the duty of good faith in defending the claim.[506]

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497 *Id.* at 766 Syl. Pt. 3.

498 *Id.* at 766 Syl. Pt. 4.

> [T]he trial court should consider whether there was appropriate investigation and evaluation of the claim based upon objective and cogent evidence; whether the insurer had a reasonable basis to conclude that there was a genuine and substantial issue as to liability of its insured; and whether there was potential for substantial recovery of an excess verdict against its insured.

Id.

499 437 S.E.2d 749 (W. Va. 1993).

500 *See id.* at 749 Syl. Pt. 5.

501 *Id.* at 753.

502 *See id.* at 752-53.

503 *See id.* at 753.

504 *See Karl*, 437 S.E.2d at 753.

505 *Id.* at 754.

506 *See id.* at 755-56.

D. *Poling v. Motorists Mutual Insurance Company*

In *Poling v. Motorists Mut. Ins. Co.*,[507] the court held that a settlement is sufficient as ultimate resolution of the underlying claim,[508] that punitive damages are appropriate so long as the defendant's conduct meets the standard of willful, malicious, and intentional,[509] and that loss of consortium claims are proper in third party bad faith claims.[510]

The accident in *Poling* was the classic third party insurance automobile accident in which the plaintiff/third party was struck by the defendant's insured.[511] The insured was drunk, driving his father's car without permission and without a valid driver's license.[512] The plaintiff's truck tumbled down a 300 foot embankment, rendering it a total loss.[513] There was no dispute over the property damage claim; however, the defendant did dispute the severity of the plaintiff's injuries.[514] Twelve months after the accident, the insurer agreed to settle for the personal injury policy limits and for the total amount of property damage.[515] The plaintiff refused to include the insurance company in its release, and later brought a bad faith claim in the Federal District Court for the Northern District of West Virginia.[516] The federal court certified three questions to the West Virginia Supreme Court of Appeals.[517]

On the first issue, the court ruled that "[a]lthough a voluntary settlement is not a judicial determination, it is an ultimate resolution of a cause of action."[518] The court noted that the insurance company knew it was not being released and held that so long as the insurer is not included in the release, the release does not preclude the bringing of an action for bad faith.[519] The court also approved the awarding of punitive damages in third party bad faith cases so long as the plaintiff shows that the insurer knew that the claim was proper and "willfully, maliciously

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507 450 S.E.2d 635 (W. Va. 1994).

508 *See id.* at 635 Syl. Pt. 1.

509 *See id.* at 637-38.

510 *See id.* at 635 Syl. Pt. 4.

511 *See id.* at 636.

512 *See Poling*, 450 S.E.2d at 636.

513 *See id.*

514 *See id.*

515 *See id.*

516 *See id.*

517 *See Poling*, 450 S.E.2d at 636-37.

518 *Id.* at 637.

519 *See id.*

and intentionally delayed payment in order to attempt to obtain a less than just settlement."[520] Finally, the court ruled that the spouse of an injured person may maintain an independent claim for loss of consortium in a third party bad faith case.[521]

E. State ex rel. State Farm Fire & Casualty Company v. Madden

In *State ex rel. State Farm Fire & Cas. Co. v. Madden*, the court held that an action for bad faith may be brought at the same time that the underlying claim is filed.[522] The plaintiff in *Madden* was injured when he slipped and fell in the snow at a Wendy's restaurant.[523] In an amended complaint, the plaintiff sued both Wendy's and its insurer, State Farm.[524] The defendants filed writs of prohibition seeking review of several orders including the court's allowance of both actions and its refusal to bifurcate the actions.[525]

The court affirmed the trial court's decision to allow the plaintiff to sue the insurer at the same time as the defendant.[526] However, the court disagreed with the lower court on the issue of bifurcation.[527] On that issue, the court held that the trial court must bifurcate the actions:

> under Rule 18(b), WVRCP [1978], an insurer may be joined as a defendant with the insured by an injured plaintiff alleging claims of bad faith and unfair insurance practices. However . . . [t]o prevent undue prejudice to [the insured] any discovery or additional actions against the insurer . . . must be stayed pending resolution of the underlying suit.[528]

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520 *See id.* at 638.

521 *See id.*

522 451 S.E.2d 721 (W. Va. 1994).

523 *See id.* at 722.

524 *See id.* at 723 n.1 (the counts included negligence on the part of Wendy's, and both common law bad faith and violation of the unfair insurance claim practices act against State Farm).

525 *See id.* at 723.

526 *See id.* at 724.

527 *See Madden*, 451 S.E.2d at 724.

528 *Id.*

F. *Charles v. State Farm Automobile Ins. Company*

In *Charles v. State Farm Auto. Ins. Co.*,[529] a train struck a car stalled on railroad tracks, killing Deborah Jewell and injuring Stanley Bowen.[530] Complaints, counterclaims, and cross claims ensued. Ultimately, the railroad company settled with Jewell's estate for $50,000.00, and at trial, Bowen was found to be 100% liable for Jewell's death.[531] Bowen's defense at trial was provided by State Farm, the insurer of the car in which he and Jewel were riding.[532] State Farm made no attempt to settle with the estate and throughout the litigation believed it would avoid liability because of the lack of cooperation of Bowen in providing his defense.[533]

The court rendered two decisions in *Charles*. The first opinion[534] was withdrawn and revised upon rehearing. In its first decision, the West Virginia Supreme Court of Appeals held that Bowen was an additional insured under the State Farm policy and that the *Shamblin* doctrine applied.[535] Justice Neely's decision held that State Farm was responsible for the entire excess verdict, less the amount of the railroad company's settlement, because it made no effort whatsoever to settle.[536] As to the issue of Bowen's lack of cooperation in his defense, the court held that it did not matter, for he was not the policy owner and "it would be absurd to hold that the actions of itinerant n'er-do-well permissive user can bankrupt a policy holder who, in any event, has no control over the n'er-do-well permissive user."[537]

On rehearing, the court withdrew its initial decision.[538] In the second opinion, the court held that although Bowen was not the policy owner, he was an insured and was entitled to *Shamblin* doctrine protection so long as he had not forfeited his rights under *Bowyer v. Thomas*.[539] The case was remanded to the

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529 452 S.E.2d 384 (W. Va. 1994).

530 *See id.* at 386.

531 *See id.* at 387.

532 *See id.* (the car was owned by Jewell's father, James Muncy).

533 *See id.* at 388.

534 Charles v. State Farm Auto. Ins. Co., No. 21662 (W. Va. June 15, 1994).

535 *See id.* at 1-2.

536 *See id.* at 7-8.

537 *Id.* at 4.

538 *See Charles*, 452 S.E.2d at 386.

539 *See id.* at 389 (citing *Bowyer*, 423 S.E.2d 906 (W. Va. 1992) (providing that coverage is voided if the insurer exercises reasonable diligence in attempting to obtain the insured's cooperation, the insured's failure to cooperate is substantial and prejudicial, and the insured willfully and intentionally violated the cooperation clause)).

circuit court for determination of the *Bowyer* test.[540] In dicta the court also stated the following:

> No one has yet suggested that the purpose of the *Shamblin* doctrine is to protect victims, although the recent case of *Marshall v. Saseen*, indicates that a victim may assert a bad faith against an insurance carrier and demand that the carrier meet the *Shamblin* standard to exonerate itself. Nonetheless, regardless of the final contours of the law that has just been adumbrated in *Marshall*, it is beyond cavil that the original *Shamblin* doctrine was created to protect policyholders who purchase insurance to safeguard their hard-won personal estates and then find these estates needlessly at risk because of the intransigence of an insurance carrier.[541]

This statement addresses the issue of whether a third party claimant may bring a bad faith claim directly against the insurer, but it by no means settles the issue. In fact, the next two cases discussed show that the federal courts in West Virginia recognize that the issue has not been decided and establish a strict rule of prohibiting direct common law bad faith actions against the insurer in the federal district courts.

G. *Cross v. State Farm Mutual Automobile Insurance Company*[542]

In this case, the insured and third party claimant were involved in an automobile accident.[543] The insurer determined that its insured was liable and contacted the third party claimant and attempted to settle.[544] The third party claimant was unhappy with the offer and hired a lawyer.[545] Thereafter, the insurer refused to make any further payments until final resolution of the case.[546] The underlying case was eventually settled, and this bad faith claim ensued. The trial court granted summary judgment for the insurance company.[547] The Fourth Circuit affirmed summary judgment on the common law bad faith claim, holding that "the district court correctly concluded that, like most other jurisdictions, West Virginia would not allow third parties to assert common law causes of action for bad

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540 *See id.* at 390.

541 *Id.* at 389 (citation and footnote omitted).

542 No. 96-1241, 1996 U.S. App. LEXIS 33933 (4th Cir. Dec. 31, 1996).

543 *See id.* at *1.

544 *See id.* at *1-2.

545 *See id.* at *2.

546 *See id.*

547 *Cross*, 1996 U.S. App. Lexis 33933 at *2.

faith."[548]

H. *Penix v. Nationwide Mutual*[549]

This case also arose out of an automobile accident. The third party sued the insured, and the claim was eventually settled.[550] The third party then sued the insurer for common law bad faith and violation of the unfair insurance practices act.[551] In its order granting summary judgment for the insurer, the trial court judge stated that "this court is unaware of any West Virginia decision which has allowed a third-party claimant a direct right of action under an insurance policy for damages beyond the coverage available under the policy."[552]

V. WEST VIRGINIA CAUSE OF ACTION

As opposed to the other three bad faith causes of action discussed in this article, there are only three sequential steps in a third party common law bad faith action: (A) resolution of the underlying claim, (B) bad faith, and (C) willful, malicious, and intentional conduct. These three steps are discussed below.

A. *Underlying Claim Is Ultimately Resolved*

The first sequential step is establishing that the underlying claim has been ultimately resolved. Any final resolution will do, including judgment on a jury verdict, summary judgment, or directed verdict. In addition, because the court held in *Poling* that a settlement between the plaintiff and the insured is an ultimate resolution for purposes of proceeding with a bad faith claim, a jury verdict or judicial disposition is not necessary.[553]

Although the underlying claim must be ultimately resolved as a prerequisite to seeking recovery of bad faith damages, the insurer may be joined in an action against the insured or added by an amended complaint in the underlying action.[554] The complaint in *Madden*, filed by the third party plaintiff, alleged not only negligence on the part of the insured, but also counts of both statutory and common law bad faith against the insurer.[555] Although combination of these causes

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548 *Id.* at *3.

549 No. 2:95-0525 (S.D.W.Va. Jan. 10, 1995).

550 *See id.*

551 *See id.*

552 *Id.*

553 *Poling*, 450 S.E.2d at 637.

554 *Madden*, 451 S.E.2d at 722 Syl. Pt. 1.

555 *See id.* at 722 n.1.

of action is allowed, they must be bifurcated, and discovery on the bad faith issue must be stayed and kept separate from the liability claim discovery.[556] A plaintiff may also amend the complaint after judgment to add allegations of bad faith upon resolution of the underlying claim.[557] There is a clear benefit to the insured in allowing joinder of the two claims, for it will usually prevent removal of the bad faith cause of action to federal courts.

When ultimate resolution of the underlying claim is established, the insurer will be liable to the plaintiff insured for any award of damages against the insured in the amount of the underlying verdict up to the policy limits. Once ultimate resolution is determined, the question becomes whether the insurance company's actions in the underlying claim constitute bad faith.

B. Bad Faith

The next second step in the third party common law bad faith context is the establishment of bad faith. West Virginia law is unique in this area. The plaintiff has the initial burden of establishing a prima facie case of bad faith.[558] If the insured can establish an act of bad faith, then the burden shifts to the insurer to prove by clear and convincing evidence that it acted in good faith.

The *Shamblin* court provided a list of factors that the trier of fact should consider in determining whether an insured's refusal to settle was reasonable and in good faith.[559] These include whether there was appropriate investigation and evaluation of the claim "based on objective and cogent information;" whether the insurer had a reasonable basis to question the existence of a "genuine and substantial issue as to liability of its insured;" and whether there existed a "potential for substantial recovery of an excess verdict of [the] insured."[560] The court stressed that all of these factors could and should be considered independent of each other.[561] The court also hinted at a fourth factor, an affirmative requirement of seeking settlement.[562]

What the insurer must prove by clear and convincing evidence is that it acted as a reasonably prudent insurance company would, and did so while affording the insured's interest at least as much consideration as it gave its own, and the

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556 *See id.* at 722 Syl. Pt. 2.

557 *Id.*

558 *See Shamblin*, 396 S.E.2d at 768 Syl. Pt. 2.

559 *See id.* at 768 Syl. Pt. 4.

560 *See id.*

561 *See id.*

562 "Likewise it is the insured's burden to act in good faith in actively seeking settlement and release of its insured from personal liability, as opposed to the obligation being solely on the injured party, his attorney or the insured." *See id.* at 777.

insurance company must always be mindful of its duty of good faith and fair dealing under the policy.[563] While the *Shamblin* decision dealt with the insurer's liability for bad faith in rejecting a policy limits settlement offer, however, there is no reason to believe that liability for bad faith is solely applicable to this situation. Other acts of bad faith for which a plaintiff may sue are discussed in the next subsection.

The clear and convincing standard pushes the insurer's burden of proof to the boundary of strict liability. The court has not elaborated on the clear and convincing standard in the bad faith context; however, it has been discussed in the area of libel and slander.[564] "[C]lear and convincing evidence is . . . more than a mere preponderance of evidence. Clear and convincing evidence is that evidence which is so clear, explicit and unequivocal as to leave no substantial doubt and which is sufficiently strong to command the unhesitating assent of every reasonable mind."[565] Black's Law Dictionary defines the standard as:

> that proof which results in reasonable certainty of the truth of the ultimate fact in controversy. Proof which requires more than a preponderance of evidence but less than proof beyond a reasonable doubt. Clear and convincing proof will be shown where the truth of the facts asserted is highly probable.[566]

This is an extraordinarily difficult obstacle for the insurer and one which is unique to West Virginia in third party bad faith law.

A plaintiff who prevails under the second sequential step is entitled to a broad range of tort related damages. The insurer will be liable for consequential and compensatory damages. This will include the amount of the excess verdict rendered against the insured. The insurer will also be liable for the plaintiff's net economic loss as well as damages for aggravation and inconvenience and emotional distress. Emotional distress damages include compensation for anger, anguish, chagrin, depression, disappointment, embarrassment, fear, fright, grief, horror, humiliation, shame, and worry. In addition, a plaintiff may recover from the insurance company the plaintiff's attorney's fees and costs associated with bringing the underlying action.

Bad faith experts have harshly criticized the court for the law as it is set forth in *Shamblin.* The editors of the Bad Faith Law Report call *Shamblin* "cruel and unusual punishment" and "the worst bad faith decision published in the reports

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563 *See id.* at 768 Syl. Pt. 4.

564 *See generally* Sprouse v. Clay Communications, Inc., 211 S.E.2d 674 (W. Va. 1975).

565 *Id.* at 698.

566 BLACK'S LAW DICTIONARY 251 (6th ed. 1990) (citations omitted).

of American courts."[567] Another bad faith expert termed the decision "unusual."[568]

C. *Willful, Malicious, and Intentional*

The final step in third party bad faith cases is proof of willful, malicious, and intentional conduct for purposes of recovering punitive damages. Punitive damages are available where the plaintiff can establish that the insurer (1) knew that the claim was proper and (2) acted willfully, maliciously, and intentionally in failing to settle the claim.[569] In *Poling*, the court couched the second element of actual malice as willfully, maliciously, and intentionally "delay[ing] payment in an attempt to obtain a less than just settlement."[570] If the plaintiff can establish that the insurer knew that a claim was proper and acted in a way that rises to the level of willful, malicious, and intentional misconduct, the final sequential step is satisfied, and an insurer will be liable for punitive damages in addition to the damages recoverable under the two previous steps.

VI. QUESTIONS, ANSWERS, AND THE FUTURE

Because West Virginia began developing its bad faith law comparatively late, several important questions remain unanswered or unclarified. This section will address some of the more important issues.

A. *May Third Party Claimants Bring Direct Actions for Bad Faith Against an Insurer?*

All states have rejected the right of a third party claimant to bring a direct bad faith common law cause of action against an insurer. Courts conclude that the duty owed under the implied covenant of good faith protects the insured and is not available to protect strangers to the insurance policy.[571] Although courts have generally held against the claimant's direct cause of action, most allow assignment of the insured's cause of action against the insurer.[572] This transaction is normally

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567 Bad Faith Law Report, at 219 (Dec., 1990). The editors finished their criticism with the following warning to insurance companies who sell policies in West Virginia: "if you decide to reject a policy limits settlement offer, you might as well waive your limits and save yourself the horrendous expense of litigation in West Virginia. Adjust your rates accordingly." *Id.* at 220.

568 PAT MAGARICK, EXCESS LIABILITY: THE LAW OF EXTRA-CONTRACTUAL LIABILITY OF INSURERS § 10.04 (3d ed. 1994).

569 *See Poling*, 450 S.E.2d at 638.

570 *Id.*

571 *See* ASHLEY, *supra* note 401, at §6.09; SHERNOFF, *supra* note 228, at §2.04[2]; *see also* Annotation, *Right of Injured Person Recovering Excess Judgment Against Insured to Maintain Action Against Liability Insurer for Wrongful Failure to Settle Claims*, 63 A.L.R.3d 677 (1975).

572 *See id.*

contained in the settlement and release in which the third party claimant receives the assignment in consideration for releasing the insured from liability under the judgment in the underlying claim.[573]

In 1998, the West Virginia Supreme Court of Appeals ended the confusion over cases by third party claimants.[574] On August 10, 1990, Chester Workman crossed the center line and collided with Mr. Elmore's car, killing his pregnant wife and unborn child and injuring Mr. Elmore and his three-year-old son.[575] Workman was insured by State Farm for $300,000 (per occurrence) and Mr. Elmore had underinsured motorist coverage with Allstate.[576] Defendant Roberta Paugh, a State Farm adjuster, told Mr. Elmore "that he would not receive the entire $300,000 . . . because $100,000 was being retained . . . to settle the claims of the passengers in the Workman vehicle. Allstate instructed [Mr. Elmore] to first settle with State Farm before filing his claim for underinsured coverage with Allstate."[577] Mr. Elmore told State Farm that he wanted to get an attorney, but Defendant Paugh talked him out of it, saying that he was getting the maximum that the policy could pay anyway.[578] Mr. Elmore signed the releases pro se.[579] Unknown to Mr. Elmore, State Farm had paid only approximately $58,000 of the $100,000 it had reserved for the passengers in Mr. Workman's car.[580] Mr. Workman subsequently made a claim to Allstate for his underinsured motorist coverage, but for two years the claim was neither paid nor denied.[581] Finally, Mr. Elmore filed suit against State Farm, Allstate, and the claims adjusters claiming bad faith.[582] Allstate denied coverage on the basis that Mr. Elmore had not received all of the policy limits from State Farm.[583] State Farm quickly paid Mr. Elmore the difference, thereby reaching the policy limits of Mr. Workman's policy.[584] Mr. Elmore alleged a breach of fiduciary duty and implied covenant of good faith and fair dealing against State Farm, Allstate, and the claims adjusters.[585]

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573 *See id.*

574 *See* Elmore v. State Farm Mut. Ins. Co., 504 S.E.2d 893 (W. Va. 1998).

575 *Id.* at 895.

576 *Id.*

577 *Id.* at 894.

578 *Id.* at 895.

579 *Elmore*, 504 S.E.2d at 895.

580 *Id.*

581 *Id.*

582 *Id.*

583 *Id.*

584 *Elmore*, 504 S.E.2d at 895.

585 *Id.* at 897.

The court determined that the common law duty of good faith and fair dealing is a duty based on contract.[586] Because there is no contractual relationship between a third party and a liability insurer, there can be no bad faith and hence no direct action by a third party against an insurance company.[587] The court noted at length, however, that this decision does not affect the third party's right to sue an insurer for violation of the Statutory Unfair Claims Settlement Practices Act.[588]

B. *What is the Appropriate Statute of Limitations?*

In *Comunale v. Traders and Gen. Ins. Co.*,[589] the California Supreme Court held that the cause of action for bad faith sounds in both tort and contract law, and therefore, the plaintiff may select between these theories and be subject to the applicable limitations period. Although it is difficult to generalize, most states have adopted as the applicable time period the normally longer period allowed under statutes of limitations for causes of action arising under written contracts.[590] Under West Virginia's statute of limitations, the applicable time period for an action on a tort that was not recognized under common law is one year.[591] The applicable time period for an action on a written contract is ten years, and on an implied contract it is five years.[592] Although the insurance policy is a written contract, the duty of good faith and fair dealing is a covenant implied in every insurance contract. In this area, the court will probably follow the majority and hold that the appropriate statute of limitations period is that of an implied contract, thus requiring that bad faith actions be brought within five years.

C. *Defenses Available to the Defendant/Insurer*

Two frequently discussed defenses that may be available to the insurer are comparative bad faith and reverse bad faith. These concept are recent developments in bad faith law and have received limited acceptance, mainly in California. Both are mentioned here because of their possible future application in West Virginia.

1. Comparative Bad Faith

When courts speak of the implied duty of good faith and fair dealing, they

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586 *Id.*

587 *Id.*

588 *Id.* at 902 (citing W. VA. CODE § 33-11-4(9) (1996)).

589 328 P.2d 198 (Cal. 1958).

590 *See* ASHLEY, *supra* note 401, at §7.05; SHERNOFF, *supra* note 228, at §20.07[3][a].

591 W. VA. CODE §55-2-12 (1994).

592 W. VA. CODE §55-2-6 (1994).

recognize this as a duty not only of the insurer but also of the insured. The insured also covenants that it will do nothing to interfere with the insurer's ability to perform its obligations under the contract. When raised as a defense, the insured's bad faith has been termed comparative bad faith. This defense is based upon comparative fault principles in tort law. It is used in attempt to lessen the amount of extra contractual damages sought by the insured.

The insured's conduct may affect the insurer's ability to handle the claim in several ways. The conduct may affect the speed, accuracy, or cost of handling the claim.[593] Likewise, if the plaintiff's conduct occurs after the insurer has already acted wrongfully, it may increase the size of damages resulting from the insurer's wrongful conduct.[594] The comparative bad faith defense would put before the trial court the question of the plaintiff's bad faith in the claims process as well as the insurer's bad faith conduct. The fact finder would make the decision as to the percentage of fault attributable to the plaintiff, and the bad faith verdict would be diminished accordingly.

The question of whether to allow a defense of comparative bad faith leads to several more questions that must be addressed for proper application according to one writer.

> The adoption of a comparative fault scheme would add four decisional steps to the factfinder's task. First, by what standard should the insured's conduct be judged, and are there categories of conduct that should not count at all towards the defense? Second, was this conduct an actual cause of the injury or damages for which the insured seeks recovery? Third, was this conduct a proximate cause of the damages for which the insured seeks recovery? Fourth, what is the respective responsibility of both the carrier and the insured?[595]

Because this defense is closely related to usual comparative tort principals, an insurer would be advised to assert the defense in its initial responsive pleading to guard against waiver.

2. Reverse Bad Faith

Reverse bad faith is an independent cause of action by the insurer against the insured. This claim seeks to recover damages that the insurer has suffered as a result of the insured's misconduct. Examples of such damages may include

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593 *See* Ellen Smith Pryor, *Comparative Fault and Insurance Bad Faith,* 72 TEXAS L. REV. 1505, 1510 (1994).

594 *See id.*

595 *Id.* at 1533.

payment made to an innocent co-insured, payment made to a mortgagee for loss occasioned by an insured's fraud such as arson, investigation costs incurred that revealed the insured's fraud, and loss of subrogation rights.[596]

D. Other Prima Facie Cases of Bad Faith

Third party common law bad faith arose out of conflicts over the insurer's failure to settle. Although that is generally the context in which third party bad faith is addressed, courts have not confined the idea of bad faith conduct only to a failure to settle within policy limits. Courts from around the country have characterized the nature of bad faith conduct as "affirmative misconduct, without good faith defense, in a malicious, dishonest, or oppressive attempt to avoid liability,"[597] or "arbitrary, reckless, indifferent or intentional disregard of the interests of the person owed a duty."[598] These descriptions reveal many examples of conduct that would constitute a *prima facie* case of third party bad faith.

Examples of other conduct that courts have deemed bad faith and allowed recovery include 1) failure to advise insured to retain separate counsel,[599] 2) failure to defend,[600] and 3) improper or ineffective defense.[601] A variety of sources give examples of third party bad faith in West Virginia. One such source is West Virginia's Unfair Claims Settlement Practices Act.[602] Actions delineated in the statute that would apply to third party cases include [1] misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;[603] [2] failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;[604] [3] failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;[605] [4] refusing to pay claims without conducting a reasonable investigation based upon all available information;[606] [5] delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal

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596 *See* SHERNOFF, *supra* note 228, at §30.03[2].

597 First Maine Ins. Co. v. Booth, 876 S.W.2d 255, 257 (Ark. 1994).

598 Commercial Union Ins. Co. v. Liberty Mut. Ins. Co., 393 N.W.2d 161, 164 (Mich. 1986).

599 1 JOHN C. MCCARTHY, RECOVERY OF DAMAGES FOR BAD FAITH § 2.8 (5th ed. 1990).

600 *Id.* at § 2.9.

601 *Id.* at § 2.10.

602 W. VA. CODE § 33-11-4(9) (1996).

603 W. VA. CODE § 33-11-4(9)(a) (1996).

604 W. VA. CODE § 33-11-4(9)(b) (1996).

605 W. VA. CODE § 33-11-4(9)(c) (1996).

606 W. VA. CODE § 33-11-4(9)(d) (1996).

proof of loss forms, both of which submissions contain substantially the same information;[607] [6] failing to promptly settle claims, where liability has become reasonably clear, under one portion of the policy coverage in order to influence settlements under other portions of the insurance policy coverage;[608] [7] failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.[609]

IV. THIRD PARTY INSURANCE STATUTORY CLAIMS MISCONDUCT

I. INTRODUCTION

This section of the article concerns statutory claims misconduct by a liability insurer. Claims misconduct usually occurs due to unfair trade practices or unfair settlement practices. West Virginia Code sections 33-11-1 et. seq. contains the state's Unfair Trade Practices Act,[610] which prohibits unfair trade practices as well as unfair claims settlement practices.[611] It expressly provides for administrative remedies.[612] In addition, five jurisdictions, including West Virginia, have judicially construed the Act to allow for a private cause of action.[613] In West Virginia, a private cause of action may be brought by the third party insured against his own insurer or by the third party claimant against the liability insurer.[614]

A typical cause of action for statutory misconduct consists of four sequential steps: 1) ultimate resolution of the underlying claim,[615] 2) proof that the insurance company violated the statute,[616] 3) frequency of violations as to indicate a general business practice,[617] and 4) willful, malicious, and intentional conduct.[618]

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607 W. VA. CODE § 33-11-4(9)(l) (1996).

608 W. VA. CODE § 33-11-4(9)(m) (1996).

609 W. VA. CODE § 33-11-4(9)(n) (1996).

610 W. VA. CODE § 33-11-1 to -10 (1996).

611 W. VA. CODE § 33-11-4(9) (1996).

612 *Id.*

613 The other states are Kentucky, *see* State Farm Mut. Auto Ins. Co. v. Reeder, 763 S.W.2d 116 (Ky. 1989); Montana, *see* Klaudt v. Flink, 658 P.2d 1065 (Mont. 1983); and North Dakota, *see* Farmer's Union Cent. Exch. Inc. v. Reliance Ins. Co., 626 F. Supp. 583 (D.N.D. 1985).

614 *See Jenkins*, 280 S.E.2d at 258.

615 *See id.* at 259.

616 *See, e.g.*, Dodrill v. Nationwide Mut. Ins. Co., 491 S.E.2d 1 (W. Va. 1996).

617 *See Jenkins*, 280 S.E.2d at 260.

This section of the article will survey the history of third party insurance statutory claims misconduct in both the nation and West Virginia. Additionally, this section will analyze the national law norms, West Virginia law, and the West Virginia cause of action.

II. HISTORY

A. National

Insurance regulation is primarily a state rather than a federal responsibility. In 1944, in *United States v. Southeastern Underwriters Ass'n*,[619] the Supreme Court held that insurance companies were subject to the federal anti-trust laws.[620] Response to Southeastern was swift. In 1945, Congress passed the McCarran-Ferguson Act.[621] After concluding that "state regulation and taxation of the insurance business is in the public interest," Congress gave the power to regulate insurance companies to "the several states."[622] Federal law does not supersede state law unless the federal law specifically relates to insurance.[623] General federal legislation regulating trade practices is therefore inapplicable to insurance to the extent that state law governs insurance practices.

In response to the McCarran-Ferguson Act,[624] each state was encouraged to enact its own laws regulating insurance. Forty-five states adopted the Model Unfair Trade Practices Act promulgated by the National Association of Insurance Commissioners (NAIC).[625] To be effective, these acts should be interpreted liberally and construed to prevent federal entry.

B. West Virginia

West Virginia's Unfair Trade Practices Act, codified at sections 33-11-1 to -10,[626] contains eleven subsections.[627] The Act prohibits 15 unfair claim settlement

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618 *See Dodrill*, 491 S.E.2d at 1.

619 322 U.S. 533 (1944).

620 *Id.* at 562.

621 *See* 15 U.S.C. §§ 1011-15 (1994).

622 15 U.S.C. § 1012(b) (1994).

623 The only exceptions are the Sherman Act, *see* 15 U.S.C. § 1-7 (1994); Clayton Act, *see* 15 U.S.C. §§ 12-27, 44 (1994); and the Federal Trade Commission Act, *see* 15 U.S.C. §§ 41-58 (1994).

624 *See* 16 U.S.C. §§ 1011-15 (1994).

625 *See* SHERNOFF, *supra* note 228, at § 6.03[2].

626 W. VA. CODE § 33-11-1 to -10 (1996).

practices.[628] Nine of the sub-paragraphs apply to third party claims.[629] The most litigated subsection is the Unfair Claims Settlement Practices Act codified at West Virginia Code section 33-11-4(9).[630] In *Jenkins v. J.C. Penney Cas. Ins. Co.*, the West Virginia Supreme Court of Appeals held that section 33-11-4(9) allows a private cause of action[631] in a third party claim. In reaching that decision, the court used the four-part test from *Hurley v. Allied Chem. Corp.*:[632]

> (1) the plaintiff must be a member of the class for whose benefit the statute was enacted; (2) consideration must be given to legislative intent, express or implied, to determine whether a private cause of action was intended; (3) an analysis must be made of whether a private cause of action is consistent with the underlying purposes of the legislative scheme; and (4) such private cause of action must not intrude into an area delegated exclusively to the federal government.[633]

The main argument in *Jenkins* was whether the plaintiff was "a member of the class for whose benefit the statute was enacted."[634] The insurer contended that if the statute did provide for a private cause of action, it was only intended to cover insureds.[635] The insurer based its contention on *Scroggins v. Allstate Ins. Co.*, an Illinois case.[636] The *Scroggins* court held that the statute could allow for a third party cause of action, but concluded that an insurer's duty always runs to its insured.[637] The West Virginia court, however, construed the insurer s duty under the statute as independent of its duty under the contract with its insured.[638] The court held that the broad language in section 33-11-4(9) (a), (b), (c), (d), (f), (m), and (n) was applicable to both first and third party claims.[639] Reference to both "insureds"

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627 *Id.*

628 *Id.*

629 *See Jenkins*, 280 S.E.2d at 255-56.

630 W. VA. CODE § 33-11-4(9) (1996).

631 *See Jenkins*, 280 S.E.2d at 258.

632 262 S.E.2d 757 (W. Va. 1980).

633 *Id.* at 758 Syl. Pt. 1.

634 *Jenkins*, 280 S.E.2d at 252.

635 *Id.* at 255.

636 393 N.E.2d 718 (Ill. 1979).

637 *Id.* at 723.

638 *Jenkins*, 280 S.E.2d at 255.

639 *Id.*

and "claimants" in sub-paragraphs (k) and (l) "suggest[ed] a clear legislative intent that claimants are entitled to protection under this Act."[640] The second part of the *Hurley* test concerns legislative history. Although there was no legislative history concerning the Act,[641] subsection 33-11-6(c) indicated that the administrative provisions in the statute "will not absolve any person affected by such order or hearing from any other liability, penalty or forfeiture under the law."[642] A private cause of action was also consistent with the underlying legislative purpose, which was to prevent improper settlement practices.[643] The final factor mentioned in *Hurley* is whether the private cause of action under the state statute was preempted by federal law.[644] As previously stated, insurance regulation has been left to "the several states" and is not a "delegated federal concern."[645] Since *Jenkins,* a private cause of action exists for violations of West Virginia Code section 33-11-4(9) for third party claims.[646]

III. NATIONAL LAW NORM

The National Association of Insurance Commissioners (NAIC) is made up of the top insurance regulation officials of each state. The NAIC's Model Unfair Claims Settlement Practices Act was adopted by forty-five states, including West Virginia.[647] The Model Act does not expressly provide for a private cause of action for violations but gives the state's insurance commissioner the authority to order the insurance company to cease and desist from engaging in the unfair claims practice.[648] The commissioner may also, at his discretion, order payment of penalties or suspension or revocation of the insurer's license.[649] If the insurer violates a cease and desist order, the commissioner can order further penalties.[650] Most states do not recognize a private cause of action under the NAIC Act.

Only four states allow a judicially implied private cause of action.[651] In

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640 *Id.* at 256.

641 *Id.*

642 W. VA. CODE § 33-11-6(c) (1996) (stating that "[the administrative provisions will not] absolve any person affected by any such order or hearing from any other liability, penalty or forfeiture under law.")

643 *Jenkins*, 280 S.E.2d at 256.

644 *See id.* at 254.

645 15 U.S.C. § 1011 (1994).

646 *Jenkins*, 280 S.E.2d at 256.

647 *See* SHERNOFF, *supra* note 228, at § 6.03[2].

648 *Id.*

649 *Id.*

650 *Id.*

651 *See supra* note 610.

1979, in *Royal Globe Ins. Co. v. Super. Ct.*, California became the first state to permit a private cause of action.[652] Additionally, Florida has expressly authorized a private cause of action for violations of its Unfair Claims Settlement Practices Act.[653] Florida state statute section 624.155 applies to "any person,"[654] thus allowing a third party private cause of action.[655] In 1981, the West Virginia Supreme Court of Appeals, in *Jenkins v. J.C. Penney Cas. Ins. Co.*,[656] followed California's lead. West Virginia remains in a small minority of states that have held that their unfair trade practices acts convey a private cause of action. California overruled Royal Globe in 1987 in *Moradi-Shalal v. Fireman's Fund Ins. Co.*.[657] Thus, California no longer recognizes a private cause of action under its unfair claims settlement statute.[658]

IV. WEST VIRGINIA LAW—OVERVIEW

West Virginia, like the majority of states, has adopted a version of the NAIC's Model Unfair Claims Settlement Practices Act.[659] Like the Model Act, the West Virginia statute did not expressly provide for a private cause of action against violators of the statute. In 1981, however, the West Virginia Supreme Court of Appeals held in *Jenkins* that a violation of the statute could give rise to a private cause of action.[660] Since 1981, only seven third party statutory misconduct decisions have been made in West Virginia: six by the Supreme Court of Appeals[661] and two by the Fourth Circuit.[662] Even though not all sections of the Act have been analyzed, recent cases suggest that the court is still in agreement with its holding in *Jenkins*.[663] Later cases have expanded on *Jenkins*, making it easier to pursue claims

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652 592 P.2d 329 (Cal. 1979).

653 *See, e.g.*, State Farm Fire & Cas. Co. v. Zebrowski, 706 So. 2d 275 (Fla. 1997).

654 *Id.* at 277.

655 *Id.*

656 280 S.E.2d at 252.

657 758 P.2d 59 (Cal. 1988).

658 *Id.*

659 W. VA. CODE § 33-11-4(9) (1996).

660 *Jenkins*, 280 S.E.2d at 252.

661 *See* Grove v. Myers, 382 S.E.2d 536 (W. Va. 1989); Robinson Fidelity & Dep. Co., 383 S.E.2d 95 (W. Va. 1989); Robinson v. Continental Cas. Co., 406 S.E.2d 470 (W. Va. 1991); Russell v. Amerisure Ins. Co., 433 S.E.2d 532 (W. Va. 1993); State *ex rel.* State Farm v. Madden, 451 S.E.2d 721 (W. Va. 1994); Dodrill v. Nationwide Mut. Ins. Co., 491 S.E.2d 1 (1996).

662 *See* Cross v. State Farm Mut. Auto Ins. Co., No. 96-1241, 1996 U.S. App. Lexis 33933 (4th Cir. 1996); Mirandy v. Allstate Ins. Co., No. 97-1966 (4th Cir. 1998).

663 *See, e.g., Madden*, 451 S.E.2d at 721; *Dodrill*, 491 S.E.2d at 1.

against an insurer for unfair claims settlement practices.[664]

A. Statutes that Apply to Third Party Claimants

1. W. Va. Code Section 17D-4-12(f)(3)

West Virginia Code section 17D-4-12(f)(3) states that "[t]he insurance carrier shall have the right to settle any claim covered by the policy, and if such settlement is made in good faith, the amount thereof shall be deductible from the limits of liability specified in subdivision (2), subsection (b) of this section."[665] Despite no published decisions, following the precedent set in *Jenkins,* a private cause of action is likely for violation of the section. The problematic language is "and if such settlement is made in good faith."[666] "Good faith" has not been defined by the West Virginia courts.

2. W. Va. Code Section 33-11-4 (1)-(11)

a. General

West Virginia's Unfair Trade Practices Act,[667] patterned after the NAIC's Model Unfair Trade Practices Act, consists of eleven subsections. This article is concerned mostly with the section containing the Unfair Claims Settlement Practices Act.[668] Like the Model Act, West Virginia's Unfair Trade Practices Act identifies fifteen separate Unfair Claims Settlement Practices.[669] This article deals with those provisions that apply to third party claims. The court has not yet heard cases under all of the sub-paragraphs. All of the third party cases have dealt with sub-paragraph 9(f).

b. Sub-paragraphs applicable to third party claims

The nine subsections of 33-11-4(9) applicable to third party claims are sections (a), (b), (c), (d), (f), (k), (l), (m), and (n).[670] The only published decisions concern subsection (f). Subsection (a) prohibits misrepresentation of pertinent facts

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664 *See id.*

665 W. VA. CODE § 17D-4-12(f)(3) (1996).

666 *Id.*

667 W. VA. CODE § 33-11-1 to -10 (1996).

668 W. VA. CODE § 33-11-4(9) (1996).

669 *Id.*

670 *See Jenkins,* 280 S.E.2d at 255-56.

or provisions.[671] The subsection seems to be clear enough, although the word "pertinent" may be a litigation breeder. Subsection (b) concerns failure to acknowledge and act reasonably promptly with respect to claims.[672] The meaning of "reasonably promptly" would likely arouse debate. Subsection (c) involves implementing reasonable standards for prompt investigation of claims.[673] The words "reasonable standards" are likely to cause disagreement. Subsection (d) prohibits refusing to pay claims without conducting a reasonable investigation.[674] Again, the question is, "What is reasonable?" Subsection (f) prohibits "not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear."[675] This subsection is the most litigated. Every West Virginia third party case has involved this subsection. Two parts of subsection (f) arouse debate in court: what constitutes good faith and when liability is reasonably clear. Subsection (k) prohibits "[m]aking known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration."[676] Subsection (l) prohibits delaying investigation or payment of claims.[677] This subsection seems clear. Subsection (m) concerns the failure to promptly settle claims under one portion of the policy in order to influence settlements under other portions.[678] The reasons for delaying settlement of a portion of the claim would likely be argued by the parties. Finally, subsection (n) concerns failure to provide a reasonable explanation for denial of a claim or for the offer of a compromise settlement.[679] This subsection appears simple enough.

B. Regulations

West Virginia has also adopted Unfair Trade Practices Regulations that define "unfair methods of competition or unfair or deceptive acts or practices."[680] There are no published third party decisions concerning violation of the regulations.

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671 W. VA. CODE § 33-11-4(9)(a) (1996).

672 W. VA. CODE § 33-11-4(9)(b) (1996).

673 W. VA. CODE § 33-11-4(9)(c) (1996).

674 W. VA. CODE § 33-11-4(9)(d) (1996)

675 W. VA. CODE § 33-11-4(9)(f) (1996).

676 W. VA. CODE § 33-11-4(9)(k) (1996).

677 W. VA. CODE § 33-11-4(9)(l) (1996).

678 W. VA. CODE § 33-11-4(9)(m) (1996).

679 W. VA. CODE § 33-11-4(9)(n) (1996).

680 W. VA. CODE OF STATE R. tit. 114 § 14(1) (1987).

V. WEST VIRGINIA CAUSE OF ACTION

A. *Introduction*

A complete cause of action for third party violation of the West Virginia Unfair Claims Settlement Practices Act contains four sequential steps: 1) ultimate resolution of the underlying claim, 2) violation of the statute, 3) violations committed with such frequency as to indicate a general business practice, and 4) willful, malicious, and intentional conduct. The third party plaintiff does not have to prove all four elements in order to win a judgment against the insurance company. Rather, damages are awarded for the successful completion of each step. If the third party plaintiff proves the first element, he is awarded damages up to the policy proceeds. If he can also prove the second and third elements, violation of the statute committed with such frequency to indicate a general business practice, he is also awarded damages for aggravation and inconvenience: emotional anguish, chagrin, depression, disappointment, embarrassment, fear, fright, grief, horror, humiliation, shame and worry, attorney's fees, costs, excess over policy limits, expenses, loss of consortium, and net economic loss. If, in addition to sequential steps 1, 2, and 3, the third party plaintiff proves the insurance company's conduct was willful, malicious, and intentional, he is entitled to punitive damages.[681]

B. *Sequential Steps in a Third Party Cause of Action*

1. Sequential Step One: Ultimate Resolution of the Underlying Claim

The first element of a third party private cause of action is that the underlying liability claim must be ultimately resolved. *Jenkins v. J.C. Penney Cas. Ins. Co.*[682] was the first case. After a car accident caused by another driver, Sharon Jenkins brought a direct action against the defendant's insurer for statutory bad faith.[683] The trial court dismissed the case against the insurer because there was no private cause of action for violation of the statute.[684]

The West Virginia Supreme Court of Appeals held that there was an implied private cause of action under the Act.[685] The direct action against the insurer, however, would have to wait until the underlying claim was ultimately

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681 *See Dodrill*, 491 S.E.2d at 14.

682 280 S.E.2d 252 (1981).

683 *Id.* at 254.

684 *Id.*

685 *Id.* at 258.

resolved.[686] At that time, the issues of liability and damages would be settled, and the insurer's actions in settling the claim could be viewed in light of the outcome of the underlying case.[687] Without a verdict in the liability claim, it would be difficult to decide whether a settlement offer was fair[688] or whether liability was reasonably clear at the time of the settlement offer.[689] The two adversarial parties would be expected to disagree as to whether the settlement offer was fair or the liability was reasonably clear.[690] *Jenkins* did not mention when the underlying case would be considered ultimately resolved. Once a jury had reached a decision in the underlying case, it would be easier to determine whether liability was reasonably clear at the time of the settlement offer. The amount offered by the insurance company to settle all claims could be viewed in light of the damages awarded by the jury.

In *Robinson v. Continental Casualty Co.*,[691] the plaintiff sued the insurance company after the trial court verdict in the underlying case.[692] The plaintiffs began discovery in preparation for the second suit.[693] Discovery entailed not only requests for the insurer's claims files, but also depositions of the insurer's employees.[694] The West Virginia Supreme Court of Appeals held that to allow the plaintiffs to proceed with their suit against the insurance company and particularly to proceed with discovery would prejudice the underlying case then on appeal.[695] The court stated that "ultimately resolved" means exactly "what it appears to mean, . . . resolved after any and all appeals."[696] The issues of whether the settlement offered was fair or the liability was reasonably clear are not resolved until the appeals process is finished. Also, if on appeal the trial court's verdict was sustained, the parties might reach a reasonable settlement before the plaintiff's second suit, thus saving valuable time and "needless litigation."[697]

In *Russell v. Amerisure Ins. Co.*, the court reiterated the necessity of resolving the underlying claim before bringing a cause of action against the

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686 *Id.* at 259.

687 *Jenkins*, 280 S.E.2d at 259.

688 *Id.*

689 *Id.*

690 *Id.*

691 406 S.E.2d 470 (1991).

692 *Id.* at 470.

693 *Id.* at 471.

694 *Id.*

695 *Id.*

696 *Robinson*, 406 S.E.2d at 471.

697 *Id.* at 472

insurer.[698] The third party plaintiff in *Russell* dealt directly with the insurer Amerisure, without the assistance of an attorney.[699] Her only expense-related evidence was for $176.[700] Amerisure sent her a check for $700, which she returned uncashed.[701] Russell filed a complaint against Amerisure, alleging that the insurer violated West Virginia Code section 33-11-4(9).[702] Russell alleged that Amerisure committed five unfair claims settlement practices in her case.[703] The court held that Russell could not sue the insurer until the underlying suit was ultimately resolved.[704] Russell had not sued the other driver at all, and action against the other driver was by that time barred by the statute of limitations.[705] Russell stated that it was Amerisure's fault that she did not bring an underlying suit against the other driver.[706] She alleged that the insurer had also neglected to inform her of the two-year statute of limitations on her claim and had purposely delayed communications with her until the statute of limitations was about to lapse.[707] She did not produce evidence that the insurer had done so, however, and Amerisure denied committing any malfeasance.[708] The court considered allowing Russell to sue under a theory of common-law fraud, as allowed in several other jurisdictions when an insurer's malfeasance allowed a statute of limitations to run.[709] However, Russell had not produced even "a scintilla of evidence" to support a theory of common-law fraud.[710] The court did not discuss whether it would ever allow such a theory, but implied that it might.[711] Therefore, the suit against the insurer would have to be stayed pending the ultimate resolution of the underlying claim, even though the underlying claim was time-barred, unless evidence showed that the insurer fraudulently kept the claimant from suing until the statute of limitations had run.[712]

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698 433 S.E.2d 532 (1993).

699 *Id.* at 533

700 *Id.*

701 *Id.*

702 *Id.*

703 *Russell*, 433 S.E.2d at 533.

704 *Id.* at 533.

705 *Id.* at 534-35.

706 *Id.*

707 *Id.*

708 *Russell*, 433 S.E.2d at 534-35.

709 *Id.*

710 *Id.*

711 *Id.*

712 *Id.*

The last case was *State ex rel. State Farm Fire & Cas. Co. v. Madden.*[713] The plaintiff had sued Wendy's Restaurant for his injuries in a slip-and- fall accident.[714] He later amended his complaint to join State Farm as a defendant.[715] The complaint against State Farm included bad faith and violations of West Virginia Code sections 33-11-4(3), 33-11-4(5)(a) and (b), and 33-11-4(9)(d), (f), (g), and (m).[716] Judge Madden allowed joinder of the underlying suit and the third party claims against the insurer.[717] State Farm appealed.[718] The court decided that joinder of the insurer with the insured would be allowed.[719] The decision overruled *Jenkins*, *Robinson*, and *Russell.*[720] The two suits would have to be bifurcated[721] to prevent the jury in the underlying case from hearing testimony concerning insurance coverage.[722] Further, discovery against the insurer would also be stayed pending resolution of the underlying claim.[723] The court expressly stated that "[t]o the extent that the majority of states follow the rule that a party bringing a personal injury action against an insured may not sue the insurer until after having obtained judgment against the insured, we are consciously taking a step in a different direction."[724] It based its holding on Rule 18(b) of the West Virginia Rules of Civil Procedure,[725] which provides that "[a] party asserting a claim to relief . . . may join . . . as many claims, legal or equitable, as he has against an opposing party."[726] As long as the two suits were bifurcated, there would be no prejudice toward any of the defendants, and joinder of the two suits would help cut the costs of litigation, particularly filing fees.[727]

Prior to *Madden*, the plaintiff would have to wait not only for the trial court's decision, but also for the resolution of any and all appeals before bringing a

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713 451 S.E.2d 721 (1994).

714 *Id.* at 723.

715 *Id.* at 723 n.1.

716 *Id.*

717 *Id.* at 723.

718 *Madden*, 451 S.E.2d at 724.

719 *Id.* at 725.

720 *Id.*

721 *Id.*

722 *Id.* at 726.

723 *Madden*, 451 S.E.2d at 726.

724 *Id.* at 725

725 W. VA. R. CIV. P. 18(b).

726 *Id.*

727 *Id.*

cause of action against the insurer.[728] Since *Madden*, however, the underlying liability claim and the third party claim against the insurer may be brought jointly, as long as the two causes of action are bifurcated.[729] The advantages to the plaintiff are great. Obviously, the plaintiff not only saves the cost of filing two separate suits, but also avoids the case being removed to federal court.

2. Sequential Step Two: Violation of the Statute

The second sequential step in a third party claim under West Virginia Code section 33-11-4(9) is proof of violation of the statute. Although sub-paragraphs (a), (b). (c), (d), (f), (l), (m), and (n) all apply to third party claims, most causes of action brought against insurance companies have been for violation of subsection (f), "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear."[730] Every third party case heard by the West Virginia court has involved subsection (f). This step is quite simple. The plaintiff must introduce some evidence that the insurance company violated a prohibition contained in one or more of the eight applicable sub-paragraphs. For example, if the plaintiff were relying on a violation of sub-paragraph (a), the plaintiff could show that the insurer lied to the plaintiff about the defendant's liability limits. Similarly, if the plaintiff were relying on a violation of sub-paragraph (b), the plaintiff could show that the insurer refused to return the plaintiff's phone calls and refused to try to settle the plaintiff's claim against the defendant/insured.

The most troublesome sub-paragraph is (f). The term "good faith" has not been defined by the court, nor has the court specified when "liability becomes reasonably clear." We will define these terms in Part V.

In *Dodrill v. Nationwide Mut. Ins. Co.*,[731] the plaintiff charged that Nationwide violated West Virginia Code section 33-11-4(9) by not attempting in good faith "to effectuate a prompt, fair, and equitable settlement of plaintiff's claim, even though liability was reasonably clear on the part of its insured; and failed to promptly provide a reasonable explanation to plaintiff for the basis of its offer of a compromise settlement."[732] The claims were based on sub-paragraphs (f) and (n) of 33-11-4(9).[733] Nationwide had failed to settle with the plaintiff for over two years,[734] even failing to settle when the two parties were only $1,000 apart.[735]

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728 *See Robinson*, 406 S.E.2d at 470.

729 *See Madden*, 451 S.E.2d at 724.

730 W. VA. CODE § 33-11-4(9)(f) (1996).

731 491 S.E.2d 1 (W. Va. 1996).

732 *Id.* at 5.

733 *Id.* at 9.

734 *Id.* at 11.

This failure to settle violated the statute because it was evidence that Nationwide did not attempt in good faith to "effectuate a prompt fair and equitable settlement" of Dodrill's claim.[736]

3. Sequential Step Three: Committed With Such Frequency as to Indicate a General Business Practice

The third sequential step in a cause of action under West Virginia's Unfair Claims Settlement Practices Act is that the insurance company violated the Act "*with such frequency as to indicate a general business practice.*"[737] The statute itself does not define frequency.[738] However, in *Jenkins,* the court not only insisted that frequency must be proved, but then defined frequency as "more than a single isolated violation," or more extensively,[739]

> [p]roof of several breaches by an insurance company of W. Va. Code, 33-11-4(9), would be sufficient to establish the indication of a general business practice. It is possible that multiple violations of W. Va. Code, 33-11-4(9), occurring in the same claim would be sufficient, since the term "frequency" in the statute must relate not only to repetition of the same violation but to the occurrence of different violations.[740]

Russell refined the definition of frequency.[741] The plaintiff in *Russell* argued that she had "identified and pleaded five distinct violations of [the Act]."[742] The court found, however, that "the factual basis for each of these violations is the same isolated scenario and does not suffice to represent a 'general business practice.'"[743] In *Dodrill,* the court held that frequency could be shown by the repetition of the same violation or of different violations.[744] The plaintiff would have to show more than a single violation to recover.[745] Several breaches would be

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735 *Id.* at 8.

736 *Dodrill,* 491 S.E.2d at 12.

737 W. VA. CODE § 33-11-4(9) (1996) (emphasis added).

738 *Jenkins,* 280 S.E.2d at 252.

739 *Id.* at 260.

740 *Id.*

741 *Russell,* 433 S.E.2d at 536.

742 *Id.*

743 *Id.*

744 *Id.* at 13.

745 *Id.*

sufficient, however, even if they occurred in the same claim.[746] To find evidence of multiple violations, plaintiffs could look to other claimants or other persons familiar with the insurer's business practices. The list of factors is not exhaustive, but in *Dodrill,* the court held that in the settlement of a single insurance claim, the evidence should establish that

> the conduct in question constitutes more than a single violation of 33-11-4(9), that the violations arise from separate, discrete acts or omissions in the claim settlement, and that they arise from a habit, custom, usage, or business policy of the insurer, so that, viewing the conduct as a whole, the finder of fact is able to conclude that the practice or practices are sufficiently pervasive or sufficiently sanctioned by the insurance company that the conduct can be considered a "general business practice" and can be distinguished by fair minds from an isolated event.[747]

In a subsequent unpublished federal case, *Cross v. State Farm Mutual Automobile Ins. Co.*,[748] the plaintiff's case against the insurer had been dismissed at the district court level because all of the violations arose from a single case, her own.[749] The Court of Appeals reversed and remanded, citing *Dodrill*.[750]

In West Virginia, frequency which constitutes a general business practice can be shown by either the insurance company's frequent violation of one or more sections of the Act in different cases, or the company's multiple violations of the Act in one particular claim.[751] The successful completion of sequential steps 1, 2, and 3 constitutes a complete cause of action. The plaintiff is entitled to damages for aggravation and inconvenience, emotional anguish, chagrin, depression, disappointment, embarrassment, fear, fright, grief, horror, humiliation, shame, worry, attorney's fees, costs, excess over policy limits, expenses, loss of consortium, and net economic loss.[752] Attorney's fees and costs are determined at a post-trial hearing.[753]

4. Sequential Step Four: Actual Malice.

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746 *Russell*, 433 S.E.2d at 536.

747 *Dodrill*, 491 S.E.2d at 3 Syl. Pt. 4.

748 No. 96-1241, 1996 WL 742389 (4th Cir. Dec. 31, 1996).

749 *Id.*

750 *Id.*

751 *See Dodrill*, 491 S.E.2d at 13.

752 *See id.*

753 *See, e.g.*, Landmark Baptist Church v. Bhd. Mut. Ins. Co., 484 S.E.2d 195 (W. Va. 1997).

The fourth sequential step in a cause of action under the Act involves proof of actual malice. Punitive damages may then be recovered.[754] The insurer must have actually known that the claim was proper and must have willfully, maliciously, and intentionally used unfair business practices in settling or denying a claim.[755] This is intended to be a bright-line standard.[756] *Jenkins* indicated that punitive damages may be available in a statutory claim, but did not elaborate.[757] The key case on willful, malicious, and intentional conduct (the old standard) is *Poling v. Motorist's Mut. Ins. Co.*.[758] Willful, malicious, and intentional conduct is defined as when the insurer "knew [that the plaintiff's] claim was proper and willfully, maliciously, and intentionally delayed payment in order to attempt to obtain a less than just settlement."[759] Willful, malicious, and intentional conduct may also be found where the insurer knew that the plaintiff's claim was proper and willfully, wantonly, and intentionally denied payment.[760] This standard, though substantially unchanged, is now referred to by the court as actual malice. If the finder of fact determines that the insurer's conduct was that of actual malice, punitive damages are then available.

VI. OTHER ISSUES RELATED TO RECOVERY

A. Bifurcation

After *State ex rel. State Farm v. Madden*,[761] suits may be joined, but claims against the insured must be bifurcated from claims against the insurer.[762] "Under Rule 18(b), W.V.R.C.P. [1978], an insurer may be joined as a defendant with the insured by an injured plaintiff alleging claims of bad faith and unfair insurance practices."[763] To prevent undue prejudice to the defendant insured, however, "any

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754 *See, e.g., Dodrill*, 491 S.E.2d 1.

755 *See* Berry v. Nationwide Mut. Fire Ins., Co., 381 S.E.2d 367 (W. Va.1989); *see also Poling*, 450 S.E.2d at 635. Further, in *McCormick v. Allstate Ins. Co.*, 505 S.E.2d 454 (W. Va. 1998), the West Virginia Supreme Court of Appeals indicated that this actual malice standard was the standard for first party statutory insurance misconduct cases. The author assumes that the Court would apply that standard to third party statutory insurance misconduct cases as well, given that the statutes and elements making up the two causes of action are substantially the same.

756 *Id.*

757 *See Jenkins*, 280 S.E.2d at 259 n.12.

758 450 S.E.2d 635 (W. Va. 1994).

759 *Id.* at 638.

760 *Berry*, 381 S.E.2d at 369 Syl. Pt. 5.

761 451 S.E.2d at 721.

762 *Id.* at 724.

763 *Id.* at 722 Syl. Pt. 1.

discovery or additional actions against the insurer . . . must be stayed pending resolution of the underlying suit."[764] The decision in Madden was a conscious step in a different direction from the majority of states.[765] Allowing the insurer to be joined in the action with the insured prevents removal. If the plaintiff is a West Virginia citizen and the only defendant is an out-of-state insurance company, the insurance company can often have the case removed to federal court. Assuming the insured is also a West Virginia citizen, joining the two suits defeats complete diversity. Therefore, the case cannot be removed.[766]

B. Discovery

1. Timing

Under *Madden*, although suits may be joined, discovery must be stayed pending resolution of the underlying claim.[767] This prevents prejudice to the insurer.[768] Allowing a plaintiff to instigate extensive discovery would entail allowing requests for the insurance company's claim file.[769] "It is entirely possible that the contents of the insurance company's claim file would prejudice [the insured's] case."[770] It is possible that the court might restrict production of documents if the defendant so moved.[771] More than likely, it would still prejudice the defendant's case to allow the two causes of action to be tried together.[772] Having insurance at all is enough to prejudice the defendant's case "because disclosure might influence the jury to decide the underlying claim based on the fact of insurance coverage, and not on the merits of the case."[773]

2. Scope

Proving that an insurer's violations of the act were committed with such frequency as to indicate a general business practice requires extensive discovery. In some cases, such as *Dodrill*, a single claim may have enough violations occurring

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764 *Id.* at 724.

765 *Id.* at 725.

766 28 U.S.C. §1441(b) (1994).

767 *Madden*, 451 S.E.2d at 724.

768 *Id.*

769 *Id.* at 726.

770 *Id.* (citing *Robinson*, 406 S.E.2d at 471.)

771 *Id.*

772 *Madden*, 451 S.E.2d at 726.

773 *Id.* (citing Hewett v. Frye, 401 S.E.2d 222 (1990)).

to show frequency.[774] In other cases, however, the claimant will seek to show that the insurer committed multiple violations in several claims.[775] In *State Farm Mut. Auto. Ins. Co. v. Stephens*,[776] the plaintiff requested that the insurer "provide information on every claim filed against it, nationwide, since 1980 which involved allegations of bad faith, unfair trade practices violations, excess verdict liability or inquiries from insurance company regulators concerning State Farm's handling of claims."[777] This request for twelve years of documents was simply too burdensome. The court held that although it was important for the claimant to establish frequency, it would not allow unduly burdensome and oppressive discovery.[778] It limited discovery to other similar claims filed in West Virginia.[779]

The problems of extensive discovery may be answered, at least in part, if West Virginia adopts the Model Unfair Claims Settlement Practices Act, as amended in 1990 by the NAIC.[780] The NAIC has amended the Act to include violations committed with such frequency as to indicate a general business practice or violations "committed flagrantly and in conscious disregard of this Act or any rules promulgated hereunder."[781] Under the amended Act, if the claimant shows that the violation was flagrant and in conscious disregard of the Act, there would be no need to go through burdensome discovery.

C. *Damages*

Damages awarded depend on which sequential steps the plaintiff has successfully achieved. Damages awarded upon completion of step one are the policy proceeds. If the plaintiff completes step three, he may be awarded damages for aggravation and inconvenience, mental anguish, depression, disappointment, embarrassment, fear, fright, grief, horror, humiliation, shame, and worry.[782] In addition, the plaintiff may be able to recover attorney's fees, court costs, excess over policy limits, expenses, loss of consortium, and net economic loss.[783] Upon completion of step four, the plaintiff may be awarded punitive damages.[784]

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774 *See Dodrill*, 491 S.E.2d at 12.

775 *See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Stephens, 425 S.E.2d 577 (W. Va. 1992).

776 *Id.*

777 *Id.* at 580.

778 *Id.* at 585.

779 *Id.*

780 NAIC 880-1 (1997).

781 NAIC 880-1 §3(A) (1997).

782 *See, e.g., Dodrill*, 491 S.E.2d at 1.

783 *See id.*

784 *See* Poling v. Motorists Mut. Ins. Co., 450 S.E.2d 635, 638 (W. Va. 1994).

1. Fees and Court Costs

If the insurer's misconduct is found to have been a "general business practice" under sequential step 3, the claimant may be awarded attorney's fees and costs as determined in a post-trial hearing and awarded by the judge.[785] The judge will use the test from *Landmark Baptist*[786] to determine if these fees and costs are reasonable. The test consists of broad factors:

> 1) the time and labor required, 2) the novelty and difficulty of the questions, 3) the skill required to perform the legal services properly, 4) the preclusion of other employment by the attorney due to the acceptance of the case, 5) the customary fee, 6) whether the fee is fixed or contingent, 7) time limitations imposed by the client or the circumstances, 8) the amount involved and the results obtained, 9) the experience, reputation, and ability of the attorneys, 10) the undesirability of the case, 11) the nature and length of the professional relationship with the client, and 12) awards in similar cases.[787]

2. Punitive Damages

Upon completion of sequential step four, willful, malicious, or intentional conduct, the plaintiff may be awarded punitive damages.[788] The punitive damages instruction in *Dodrill* was as follows:

> 1) [P]unitive damages should bear a reasonable relationship to the harm that is likely to occur from defendant's conduct, as well as to the harm that actually has occurred. If the defendant's actions caused or would likely cause, in a similar situation, only slight harm, the damages should be relatively small. If the harm is grievous, then the damages should be much greater.
>
> 2) You may consider the reprehensibility of defendant's conduct. And in doing so, you should take into account how long defendant continued in its actions, whether they were aware that their actions were causing or were likely to cause harm, whether they attempted

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785 *See Landmark Baptist*, 484 S.E.2d at 198.

786 *Id.*

787 *Id.* at 196 Syl. Pt. 1.

788 *See, e.g., Dodrill*, 491 S.E.2d at 15.

> to conceal or cover up their actions or the harm caused by them, whether they often engaged in similar conduct in the past, and whether they have made reasonable efforts to make amends by offering a fair and prompt settlement for the actual harm caused once their liability became clear to them.[789]

3. Prepayment

"Payment for [undisputed elements of a claim] shall be made . . . where such payment can be made without prejudice to either party."[790] The question is whether and when such payments prejudice a party. In *Cross,* the insurer had been paying the claimant's medical bills and had offered $1200 to settle her claim.[791] When the claimant hired a lawyer, the insurer refused to make any more payments for lost wages or medical bills.[792] The parties finally settled for $35,000.[793] The Fourth Circuit concluded that "it would have prejudiced [the insurer] to continue paying Cross' medical bills and lost wages without any adjudication of liability or the extent of Cross' damages."[794]

VII. QUESTIONS AND ANSWERS/ THE FUTURE

Sub-paragraph (f) of the Act defines as an unfair claim settlement practice "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear."[795] This sub-paragraph is the workhorse of the Act. Because most claims filed under the Act have referred to sub-paragraph (f), it is important to define the terms that cause the most litigation: good faith and reasonably clear.

The West Virginia Supreme Court of Appeals has not defined good faith or bad faith. In other courts, good faith has been generally defined as "a state of mind denoting honesty of purpose and freedom from intention to defraud."[796] Also, "[g]ood faith is an intangible and abstract quality with no technical meaning or statutory definition. It encompasses, among other things, an honest belief, the

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789 *Id.* at 14.

790 *Cross*, 1996 WL 742389, *1 (citing W. VA. CODE STATE REGULATIONS §114-4-6(6.8)).

791 *Id.*

792 *Id.*

793 *Id.*

794 *Id.*

795 W. VA. CODE §33-1-4(9)(f) (1996).

796 *See* People v. Bowman, 320 P.2d 70, 76 (Cal. Dist. Ct. App. 1958).

absence of malice and the absence of a design to defraud or to seek an unconscionable advantage."[797] Many times, good faith is defined as a lack of bad faith:

> "[b]ad faith" as the opposite of "good faith," generally implying or involving actual or constructive fraud, or design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive.[798]

In insurance cases in particular, courts have also attempted to decide what qualifies as good faith. The Maryland District Court has held that to qualify as having acted in good faith when refusing to settle a claim within policy limits, an insurer is generally required to weigh the interests of the insured, at least equally with its own.[799] New Jersey also has used this test of balancing the insurer's interest with that of the insured.[800] The New Jersey Superior Court also stated that good faith requires that, under the circumstances of the particular case, a decision not to settle must be a thoroughly honest, intelligent, and objective one and realistic when tested by the necessarily assumed expertise of the carrier, and where the carrier recognizes the probability that an adverse verdict will exceed the policy limits, "the boundaries of 'good faith' become more compressed in favor of the insured."[801] In the Fifth Circuit Court of Appeals has used factors to decide if an insurer failed to settle in good faith. These included reasonable valuation of the case and whether, at each stage, proposed settlements were rejected consciously in terms of deliberative judgment evaluations or because of other or no reasons.[802]

Again, the court has not defined when liability becomes reasonably clear. In Massachusetts, the Appellate Court held that whether an insurer's liability has become reasonably clear is a question for the fact finder.[803] The fact finder must determine whether a "reasonable person, with knowledge of relevant facts and law, would probably have concluded, for good reason, that the insurer was liable to the plaintiff."[804]

It should be apparent that instead of restricting private causes of action

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797 Doyle v. Gordon, 158 N.Y.S.2d 248, 259-60 (1954).

798 Edwards-Warren Tire Co. v. Coble, 115 S.E.2d 852, 858 (Ga. 1960).

799 Sobus v. Lumbermen Mut. Cas. Co., 393 F. Supp. 661, 672 (D.C. Md. 1975).

800 *See* Rova Farms Resort, Inc. v. Investors Ins. Co. of America, 323 A.2d 495, 508 (N.J. 1974).

801 *Id.* at 505.

802 Smoot v. State Farm Mut. Auto Ins. Co., 299 F.2d 525, 531 (5th Cir. 1962).

803 *See* Demeo v. State Farm Mut. Auto. Ins. Co., 649 N.E.2d 803, 803 (Mass. App. Ct. 1995).

804 *Id.*

against insurers, the West Virginia Supreme Court of Appeals has been liberalizing the requirements. First, the underlying cause of action and the claim against the insurer are now allowed to be joined as long as the two are bifurcated.[805] Second, the court has broadened the requirement of frequency to include violations committed in multiple cases as well as multiple violations committed in a single case.[806] If West Virginia adopts the NAIC's revised Model Act of 1990, the claimant will no longer have to prove frequency if he can show that the violation was committed flagrantly and in conscious disregard of the Act or any rules promulgated hereunder. Although few states have adopted the Act, as amended in 1990,[807] the new language is in keeping with West Virginia's liberal interpretation of its Act. As the Act now reads, it would not matter how egregious a violation was, as long as the insurer did not commit it frequently. Because West Virginia has already found that multiple violations in a single claim suffice to show sufficient frequency to indicate a general business practice,[808] it is a small step to do away with that requirement altogether upon proof that the violation was flagrant.

Perhaps the definitions of good faith and reasonably clear liability will be clarified in the future. If not, they will continue to be litigation breeders. West Virginia is unlikely to follow California's course and overrule *Jenkins*.[809] Although California's reasons for overruling *Royal Globe* apply to any state, *Royal Globe* was overturned ten years ago, while *Jenkins* has been precedent for sixteen years.

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805 *See Madden*, 451 S.E.2d at 724.

806 *See Dodrill*, 491 S.E.2d at 1.

807 To date, only Georgia, Missouri, and Nebraska have adopted the Act. *See* SHERNOFF, *supra* note 228, at §6.

808 *See Dodrill*, 491 S.E.2d at 1.

809 280 S.E.2d 252 (W. Va. 1981).