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## TORT OF INSURER'S BAD FAITH REFUSAL TO PAY FIRST-PARTY CLAIMS

Double-digit inflation has sent the cost of living skyrocketing in recent years, making insurance coverage a basic necessity of modern life to guard against financial ruin. The death or permanent disability of a breadwinner, a lengthy hospital stay, or loss of a home or business in a catastrophe can bankrupt an individual or business entity lacking insurance protection. Anxiety about the financial consequences of such occurrences motivates the purchase of insurance against the perils attending everyday life.

When an individual buys an insurance policy, he or she does so with the expectation that the insurer will indemnify him or her against losses resulting from the covered risks.<sup>1</sup> From the purchaser's viewpoint, he or she is not merely entering into a contract for the future payment of money upon the happening of certain contingencies; he or she is purchasing security and peace of mind.<sup>2</sup> Insurance companies employ marketing techniques aimed at presenting them "not as for-profit industries selling money, but as benevolent corporations selling freedom from care."<sup>3</sup> In its advertisements, for example, the insurer may promise its policyholder to "simplify his life," to place him "in good hands," to provide him with "a piece of the rock," or to be "on his side." These slogans foster the insured's expectation that his insurance company will stand behind him in his hour of need.<sup>4</sup>

While most insurers pay legitimate claims of their policyholders in a timely fashion, in many jurisdictions the state of the law actually encourages insurance companies to deny claims or delay paying policy benefits intentionally or unreasonably. If the insured brings a court action because of the insurer's wrongdoing, a number of states will limit his or her recovery to the amount of payments due under the policy plus interest for breach of the in-

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<sup>1</sup> First-party insurance claims, as distinguished from third-party claims, are the subject of this note. First-party insurance indemnifies the policyholder for his own losses (life, health, accident, fire, and casualty), whereas third-party coverage protects the insured against liability claims by others.

<sup>2</sup> *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 404, 89 Cal. Rptr. 78, 95 (1970).

<sup>3</sup> Comment, 30 ME. L. REV. 308, 319 (1979).

<sup>4</sup> *D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 396 A.2d 780, 786 (Pa. Super. Ct. 1978).

insurance contract.<sup>5</sup> This remedy is often inadequate to compensate the policyholder for the detriment he or she may suffer as a result of the insurance company's unjust refusal to pay him or her the benefits due. By severely restricting the amount of damages recoverable, the legal system patently fails in its efforts to make the wronged policyholder whole again.

Under this state of the law, an insurance company can maximize its profits by denying or delaying payment of its insured's valid claim. The insurer is then free to invest monies rightfully due its policyholder at interest rates double the current rate of legal interest<sup>6</sup> and to earn additional profits at the expense of its insured. By playing a "waiting game" with a policyholder who is in dire financial straits following an insured loss, the insurer may coerce the policyholder into settling for less than the full benefits due him or her. Even if the insured brings a suit and obtains a judgment, the defendant insurer will have to pay only the policy amount due plus low legal interest.

A more suitable remedy is needed when an insurance company unjustifiably denies its policyholder's claim, both to compensate the insured for the total detriment he or she suffers as a result of the insurer's misconduct and to deter similar wrongdoing in the future. Courts in some states provide such a remedy by allowing a policyholder to recover consequential damages in a contract action against an insurer which breaches the terms of the policy. Other jurisdictions recognize a breach of duty by the insurance company, based on tort theories of fraud, intentional infliction of emotional distress, and bad faith. Legislatures in various states have enacted statutes permitting the insured to recover attorneys' fees and/or penalties against his or her insurer for denying or delaying payment of a valid claim.

Of all remedies available for an insurance company's refusal to honor a legitimate claim, recognition of the tort of bad faith best conforms to the "economic, social and legal realities of the

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<sup>5</sup> 16 J. APPLEMAN & J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 8881, at 634 (1968). See, e.g., *Dawkins v. Nat'l Liberty Life Ins. Co.*, 252 F. Supp. 800 (D.S.C. 1966); *Meridian Mut. Ins. Co. v. McMullen*, 152 Ind. App. 141, 282 N.E.2d 558 (1972).

<sup>6</sup> Legal interest in West Virginia, for example, is currently 6%. W. VA. CODE § 47-6-5 (1976 Replacement Vol.).

problem.”<sup>7</sup> The theory underlying this cause of action is that the insurer owes to its insured a duty of good faith and fair dealing arising under a statute or from an implied covenant in the insurance contract. For violation of this duty, a policyholder may recover compensatory damages, including damages for mental distress. In a proper case this cause of action also permits recovery of punitive or exemplary damages.

### I. LEGAL RELATIONSHIP OF INSURER AND INSURED

Insurance is a modern society's response to risk allocation. Beginning in the late nineteenth century when the industry became firmly established in the United States, the insurance business' role as an indemnifier against the risks of loss led to widespread investment fostering the economic growth of this nation. During the early years of the industry, courts declined to regulate insurance companies extensively in order to encourage their development. This laxity of the courts, coupled with an increasing demand and necessity for insurance and the growing financial resources of insurance companies, aided insurers in attaining a superior bargaining position over those seeking insurance protection.<sup>8</sup>

The industry's increasing clout prompted the United States Supreme Court in 1914 to recognize in *German Alliance Insurance Co. v. Lewis*<sup>9</sup> that the business of insurance is “clothed with a public interest.”<sup>10</sup> Therefore, the industry itself and the methods by which it does business are properly subject to strict state regulation. The duty of an insurance company to its insured is not that which arises in the usual commercial contract. Instead, this duty arises from a form of public trust, where large sums are deposited, with the right in the insured to demand and receive services when a certain contingency occurs.<sup>11</sup>

Since *German Alliance*, numerous state courts have recog-

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<sup>7</sup> *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 402, 89 Cal. Rptr. 78, 94 (1970). See text accompanying note 93 *infra*.

<sup>8</sup> Hirsch & Carpenter, *Strict Liability: A Response to the Gruenberg-Silberg Conflict Regarding Insurance Litigation Awards*, 7 Sw. U.L. Rev. 310, 310 (1975) [hereinafter cited as Hirsch & Carpenter].

<sup>9</sup> 233 U.S. 389 (1914).

<sup>10</sup> *Id.* at 415.

<sup>11</sup> *Id.* at 406-07 (by implication).

nized the quasi-public nature of the insurance industry,<sup>12</sup> as well as the adhesive nature of an insurance contract.<sup>13</sup> Insurance policies are standardized, mass-produced form contracts, the terms of which are dictated either by the insurer or, as in the case of a fire insurance policy, by the state legislature.<sup>14</sup> This fact has led virtually every jurisdiction to adopt the rule, applicable to all types of insurance policies, that ambiguous terms in an insurance contract are to be construed strictly against the insurer and liberally in favor of the insured.<sup>15</sup> Courts also construe exclusionary language in insurance policies according to this rule.

The adhesive nature of an insurance contract is one element of the special relationship that exists between an insurer and its insured. There are two additional aspects of this relationship: the state's extensive regulation of the insurance industry and the insured's reliance on the insurer's credibility. In purchasing insurance the policyholder reasonably relies on the expectation that his or her insurance company, with its vast economic resources, will provide him or her financial protection and emotional security against the risk of accidental loss. The insurer's opportunity for overreaching in this situation may create a fiduciary relationship between the contracting parties.<sup>16</sup>

This fiduciary concept has gained wide acceptance in the context of third-party (liability) insurance claims, with courts in a number of states adopting the view that an insurer owes a duty of due care<sup>17</sup> or good faith and fair dealing<sup>18</sup> to its liability insurance

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<sup>12</sup> See, e.g., *Johnson v. Continental Cas. Co.*, 201 S.E.2d 292 (W. Va. 1973).

<sup>13</sup> R. KEETON, *BASIC TEXT ON INSURANCE LAW* § 2.10(b) at 73 (1971). Adhesion contracts have been described in Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, 53 COLUM. L. REV. 1072, 1075 (1953), as "agreements in which one party's participation consists in his mere 'adherence,' unwilling and often unknowing, to a document drafted unilaterally and insisted upon by what is usually a powerful enterprise." Examples are insurance policies, commercial loan contracts, transportation contracts, and employment contracts.

<sup>14</sup> See, e.g., W. VA. CODE § 33-17-2 (1975 Replacement Vol.).

<sup>15</sup> See, e.g., *Bryan v. Peabody Ins. Co.*, 8 W. Va. 605 (1875).

<sup>16</sup> Comment, 13 TULSA L.J. 605, 613-15 (1978).

<sup>17</sup> See, e.g., *Anderson v. St. Paul Mercury Indem. Co.*, 340 F.2d 406 (7th Cir. 1965) (applying Indiana law); *Nationwide Mut. Ins. Co. v. Smith*, 280 Ala. 343, 194 So. 2d 505 (1967); *Tri-State Ins. Co. v. Busby*, 251 Ark. 568, 473 S.W.2d 893 (1971), allowing the insured to bring an action for an insurer's negligence, fraud, or bad faith in settling third-party claims.

<sup>18</sup> See, e.g., *General Accident Fire & Life Assur. Corp. v. Little*, 103 Ariz. 435,

policyholder in settling third-party claims against its insured within the limits of policy coverage. In cases where the insurer's breach of this duty results in the third party winning a judgment against the insured for an amount in excess of policy limits, many courts hold the insurer liable for the full amount of the judgment. The rationale for charging the insurance company with this excess liability is that it stands in a true fiduciary relationship to its liability policyholder against whom a claim has been made.

While many courts have recognized this good faith duty in regard to third-party insurance claims, a number have refused to do so in the first-party insurance context on the ground that no fiduciary relationship exists between the insurer and its own insured who is seeking policy benefits.<sup>19</sup> However, this distinction between third- and first-party insurance claims is more legalistic than realistic. "In both cases the insurer has contracted to protect the insured against loss. In both cases it has control over the settlement of claims. It should be liable for all loss resulting from its bad faith, whether the loss to the insured occurs from legal liability or otherwise."<sup>20</sup>

## II. REMEDIES FOR AN INSURER'S WRONGFUL REFUSAL TO PAY FIRST-PARTY CLAIMS

In jurisdictions which have yet to recognize an insurer's duty of good faith and fair dealing in handling claims made by its insured, the policyholder may bring either a contract action or another type of tort suit against an insurer who wrongfully denies or delays paying a first-party claim. The insured's burden of proving his or her insurer's misconduct varies greatly in these causes of action, as do the damages the policyholder can recover against the insurer if his or her suit is successful.

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443 P.2d 690 (1968); *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493 (Ky. 1975); *Strand v. Travelers Ins. Co.*, 300 Minn. 311, 219 N.W.2d 622 (1974).

<sup>19</sup> In *Baxter v. Royal Indem. Co.*, 285 So. 2d 652 (Fla. App. 1973), for example, the court refused to apply the duty of good faith and fair dealing to first-party claims on the ground that here the relationship between the insurer and its insured is adversarial, rather than fiduciary, in nature.

<sup>20</sup> Note, *The Availability of Excess Damages for Wrongful Refusal to Honor First Party Insurance Claims —An Emerging Trend*, 45 *FORDHAM L. REV.* 164, 178 n.99 (1976) [hereinafter cited as Note, *FORDHAM L. REV.*].

## A. Statutory Remedies

All aspects of the insurance industry are heavily regulated by legislation, and several types of statutes figure prominently in some states when an insurer denies or delays payment of a first-party claim. These include acts specifying damages for breach of an insurance contract,<sup>21</sup> allowing interest to accrue on overdue insurance benefits,<sup>22</sup> prohibiting unfair claims practices,<sup>23</sup> and limiting awards of punitive damages in court actions.<sup>24</sup> Of even greater importance in this context are statutes requiring insurers to pay benefits promptly<sup>25</sup> and those awarding attorneys' fees and/or penalties in a policyholder's action to recover payments due from an insurance company.<sup>26</sup>

In a few jurisdictions with statutes requiring insurance companies to pay claims promptly or immediately upon receipt of proper proof of loss, courts have recognized a legal duty owed by the insurer to its insured apart from their mutual obligations under the insurance contract.<sup>27</sup> The insurer's bad faith breach of

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<sup>21</sup> See, e.g., OKLA. STAT. ANN. tit. 23, § 22 (West 1955), construed in *Christian v. American Home Assur. Co.*, 577 P.2d 899 (Okla. 1978), not to limit the plaintiff's recovery in a *tort* action for the insurer's bad faith, as opposed to an action for breach of the insurance contract.

<sup>22</sup> See, e.g., HAWAII REV. STAT. § 431-455.5 (Cum. Supp. 1978); ILL. ANN. STAT. ch. 74, § 2 (Smith-Hurd 1966); MINN. STAT. ANN. § 65B.54 (Cum. Supp. 1980).

<sup>23</sup> See, e.g., CAL. INS. CODE § 790.03 (Deering Supp. 1979); COLO. REV. STAT. §§ 10-3-1101 to -1112 (1973); OR. REV. STAT. § 746.230 (1977); S.D. COMPILED LAWS ANN. §§ 58-33-1 to -58 (1978); W. VA. CODE §§ 33-11-1 to -10 (1975 Replacement Vol.).

<sup>24</sup> See, e.g., CAL. CIV. CODE § 3294 (Deering 1972), construed in *Richardson v. Employers Liability Assur. Corp.*, 25 Cal. App. 3d 232, 102 Cal. Rptr. 547 (1972), to allow punitive damages for an insurer's malicious and oppressive failure to act in good faith; MONT. REV. CODES ANN. § 17-208 (1961) [now MONT. CODE ANN. § 27-1-221], construed in *First Sec. Bank of Bozeman v. Goddard*, 593 P.2d 1040 (Mont. 1979), to permit the plaintiff-insured to recover punitive damages where the defendant-insurer's conduct is unjustifiable and constitutes "malice-in-law"; OKLA. STAT. ANN. tit. 23, § 9 (West 1955), construed in *Christian v. American Home Assur. Co.*, 577 P.2d 899 (Okla. 1978), not to preclude recovery of punitive damages in a bad faith *tort* cause of action.

<sup>25</sup> See, e.g., MONT. REV. CODES ANN. § 40-4213 (1961) [now MONT. CODE ANN. § 33-21-105]; OKLA. STAT. ANN. tit. 36, § 4405(A)(8) (1976).

<sup>26</sup> See statutes cited notes 29 and 30 *infra*.

<sup>27</sup> *First Sec. Bank of Bozeman v. Goddard*, 593 P.2d 1040 (Mont. 1979), construing MONT. REV. CODES ANN. § 40-4213 (1961) [now MONT. CODE ANN. § 33-21-105]; *Christian v. American Home Assur. Co.*, 577 P.2d 899 (Okla. 1978), construing OKLA. STAT. ANN. tit. 36, § 4405(A)(8) (1976).

this statutory duty will permit the insured to recover damages in a tort suit for all detriment proximately caused by the insurer's failure to pay the claim in a timely manner.<sup>28</sup> This is a greater measure of damages than that generally recoverable in a contract action.

Other states have enacted statutes permitting the insured to recover reasonable attorneys' fees<sup>29</sup> and/or penalties<sup>30</sup> in an action against an insurer which delays or denies payment of a legitimate claim. These statutory provisions fall into three categories. In the first category are statutes proscribing the insurer's failure to pay benefits within a certain period of time, ranging from a minimum of thirty days<sup>31</sup> to a maximum of six months.<sup>32</sup> The second cate-

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<sup>28</sup> 593 P.2d at 1047, applying MONT. REV. CODES ANN. § 17-401 (1961) [now MONT. CODE ANN. § 27-1-317], which permits recovery "for all the detriment proximately caused thereby whether it could be anticipated or not."

<sup>29</sup> See, e.g., DEL. CODE ANN. tit. 18, § 4102 (1974); FLA. STAT. ANN. § 627.428 (West 1972), repealed by 1976 Fla. Laws ch. 76-168, § 3, effective July 1, 1982; HAWAII REV. STAT. § 431-455 (1976 Replacement Vol.); NEB. REV. STAT. § 44-359 (1978); N.H. REV. STAT. ANN. § 491:22-b (Cum. Supp. 1979); N.C. GEN. STAT. § 6-21.1 (Cum. Supp. 1979) (provides counsel fees where the judgment against the insurer is \$5,000 or less); S.D. COMPILED LAWS ANN. § 58-12-3 (1978). In some states these attorneys' fee statutes are applicable only in actions against unauthorized insurers or unauthorized foreign or alien insurers. See, e.g., COLO. REV. STAT. § 10-3-1005 (1973); N.D. CENT. CODE § 26-09-15 (1978 Replacement Vol.); W. VA. CODE § 33-4-13(d) (Cum. Supp. 1979).

<sup>30</sup> See, e.g., ARK. STAT. ANN. § 66-3238 (1966 Replacement Vol.); GA. CODE ANN. § 56-1206 (1977); ILL. ANN. STAT. ch. 73, § 767 (Smith-Hurd Supp. 1979); LA. REV. STAT. ANN. § 22:658 (West 1978); MO. ANN. STAT. § 375.420 (Vernon Supp. 1980). Logically, jurisdictions which have adopted statutory no-fault automobile insurance, thus abolishing the common law tort system in part, should also enact statutes providing substantial penalties for an insurance company's failure to pay a valid claim promptly. MASS. ANN. LAWS ch. 175, § 113 0 (Michie/Law. Co-op 1977), for example, provides that if the insurer has not paid a claim within seven days after receiving its insured's completed claim forms, the policyholder may commence a civil action for payments he or she claims to be due. The claimant is entitled to recover double the amount of damage plus court costs and reasonable attorneys' fees.

<sup>31</sup> Idaho Code § 41-1839 (1977); LA. REV. STAT. ANN. § 22:657 (West 1978) (applicable to health and accident insurance, except accidental death coverage); MO. ANN. STAT. § 375.420 (Vernon Supp. 1980); OKLA. STAT. ANN. tit. 36, § 1219 (1976); TEXAS INS. CODE art. 3.62 (Vernon 1963). See Keintz & Mann, *Extra-Contract Damages for Breach of Insurance Contracts: The Statutory Approach*, 660 INS. L.J. 7 (1978) for an analysis of the penalty and attorneys' fee statutes of 14 states.

<sup>32</sup> OR. REV. STAT. § 743.114 (1977).



gory includes statutes permitting recovery of attorneys' fees or penalties if the insurer fails to pay the claim within a specified time period and fails to behave in a certain manner. The third category consists of statutes not including any specified time period for payment but imposing sanctions for the insurer's unjustified refusal to pay a claim. These acts provide penalties ranging from ten percent<sup>33</sup> to twenty-five percent<sup>34</sup> of the insurer's liability under the policy.

Language describing the nature of the insurer's misconduct triggering an award of attorneys' fees or penalties varies among statutes in the second and third categories. Statutes in several jurisdictions incorporate a bad faith standard,<sup>35</sup> while other states' acts authorize the insured's recovery of attorneys' fees or penalties when the insurer's refusal to pay a claim is "vexatious and unreasonable,"<sup>36</sup> "arbitrary, capricious, or without probable cause,"<sup>37</sup> or "without just cause or excuse."<sup>38</sup>

Courts in the majority of states having such attorneys' fee and penalty statutes hold that these laws are penal in nature and must be strictly construed.<sup>39</sup> These jurisdictions limit the insured's recovery against a recalcitrant insurer to the policy amount, the statutory penalties, and attorneys' fees when an insured brings an action on a theory of bad faith.<sup>40</sup> Only a few states hold that such attorneys' fee statutes should be liberally con-

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<sup>33</sup> MO. ANN. STAT. § 375.420 (Vernon Supp. 1980).

<sup>34</sup> GA. CODE ANN. § 56-1206 (1977); TENN. CODE ANN. § 56-1105A (1968 Replacement Vol.).

<sup>35</sup> GA. CODE ANN. §§ 56-407.1(j), 56-1206 (1977) (penalty statutes); S.C. CODE § 38-9-320 (1976) (attorneys' fee statute); TENN. CODE ANN. § 56-1105A (1968 Replacement Vol.) (penalty statute).

<sup>36</sup> ILL. ANN. STAT. ch. 73, § 767 (Smith-Hurd Supp. 1979). N.D. CENT. CODE § 26-09-15 (1978 Replacement Vol.) contains similar language.

<sup>37</sup> LA. REV. STAT. ANN. § 22:658 (West 1978).

<sup>38</sup> MO. ANN. STAT. § 375.420 (Vernon Supp. 1980). KAN. STAT. ANN. § 40-256 (1973) contains similar language.

<sup>39</sup> See, e.g., *Callum v. Farmers Union Mut. Ins. Co.*, 256 Ark. 376, 508 S.W.2d 316 (1974); *Interstate Life & Acc. Ins. Co. v. Hopgood*, 133 Ga. App. 6, 209 S.E.2d 703 (1974); *Headrick v. Pennsylvania Millers Mut. Ins. Co.*, 257 La. 1101, 245 So. 2d 324 (1971); *Fohn v. Title Ins. Corp. of St. Louis*, 529 S.W.2d 1 (Mo. 1975); *Int'l Sec. Life Ins. Co. v. Redwine*, 481 S.W.2d 792 (Tex. 1972).

<sup>40</sup> See, e.g., *Tate v. Aetna Cas. & Sur. Co.*, 149 Ga. App. 123, 253 S.E.2d 775 (1979); *Lord v. State Auto. & Cas. Underwriters*, 208 Kan. 227, 491 P.2d 917 (1971); *Housing Auth. v. Baumann*, 512 S.W.2d 436 (Mo. App. 1974); *Ranger Ins. Co. v. Macy*, 88 S.D. 674, 227 N.W.2d 426 (1975).

strued, as they are remedial in nature.<sup>41</sup>

As an alternative to a tort recovery for damages arising out of the bad faith dealings of an insurance company, attorneys' fee and penalty statutes are intrinsically inadequate. They are aimed at penalizing the insurer for its wrongdoing, not at fully compensating the insured for his or her detriment. In many cases the penalties afforded by these statutes will fall far short of compensating the policyholder for his or her pecuniary loss and mental suffering resulting from the insurer's failure to pay his or her claim. These statutes usurp the function of the jury in determining the damage award due the injured policyholder.

## B. Contract Liability

An insurance policy is a contract and is to be governed by the same principles that control other contracts.<sup>42</sup> Absent penalty statutes permitting greater recovery against an insurer for refusal to pay or settle claims, two cases decided in the nineteenth century, *New Orleans Insurance Co. v. Piaggio*<sup>43</sup> and *Hadley v. Baxendale*,<sup>44</sup> still control the amount of damages recoverable for breach of contract in most jurisdictions.

In the 1872 case of *New Orleans Insurance*, the United States Supreme Court held that in an action on an insurance contract the plaintiff's recovery is limited to the amount due under the terms of the policy plus legal interest.<sup>45</sup> Some states retain this rule today as the measure of damages for a breach of contract to pay money,<sup>46</sup> such as an insurance policy.

A slightly more liberal measure of damages is provided by the rule in *Hadley v. Baxendale*, in which the English court held that in contract law, damages recoverable for breach are limited to

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<sup>41</sup> *Hubbard v. Lumbermen's Mut. Cas. Co.*, 24 N.C. App. 493, 211 S.E.2d 544, cert. denied, 286 N.C. 723, 213 S.E.2d 721 (1975); *Hardware Mut. Cas. Co. v. Farmers Ins. Exch.*, 256 Or. 599, 474 P.2d 316 (1970).

<sup>42</sup> *Douglas v. Koontz*, 137 W. Va. 345, 71 S.E.2d 319 (1952); *Croft v. Hanover Fire Ins. Co.*, 40 W. Va. 508, 21 S.E. 854 (1895).

<sup>43</sup> 83 U.S. (16 Wall.) 378 (1872).

<sup>44</sup> 9 Exch. 341, 156 Eng. Rep. 145 (1854).

<sup>45</sup> 83 U.S. (16 Wall.) at 386-87.

<sup>46</sup> See, e.g., CAL. CIV. CODE § 3302 (Deering 1972); *Abbey v. Farmers Ins. Exch.*, 281 Minn. 113, 160 N.W.2d 709 (1968); *Evans v. Pacific Nat'l Fire Ins. Co.*, 367 S.W.2d 85 (Tex. Civ. Ct. App. 1963).

those reasonably within the contemplation of the parties at the time the contract is entered.<sup>47</sup> Various states adopt the *Hadley* approach in combination with other standards for determining recoverability of consequential damages in a contract action.<sup>48</sup>

One difficulty clearly exists with a measure of damages based on the foreseeability of consequences arising from an insurer's refusal to pay first-party claims. The purchaser's only reason for obtaining an insurance policy is to guard against *unpredictable* risks and their consequences. However, the inability of a disabled policyholder to meet mortgage obligations or the subsequent bankruptcy of an insured whose family-owned business has burned may not be held "foreseeable" or "within the contemplation of both parties at the time of contracting" if the insurance companies in these situations refuse to pay claims. On the other hand, it is arguable that these are foreseeable consequences of the insurer's denial of valid claims.<sup>49</sup>

In addition, a policyholder who loses his or her mortgaged home or goes bankrupt due to an insurance company's wrongful refusal to honor his or her valid claim will understandably suffer mental anguish as a result. However, the insured who pursues a breach of contract action against an insurer will generally be precluded from recovering damages for emotional distress. Many courts will award such damages only when the purpose of the contract, either by its provisions or within the parties' reasonable contemplation, "concerns or directly provides for the comfort, happiness or personal esteem of one of the parties."<sup>50</sup>

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<sup>47</sup> 9 Exch. 341, 156 Eng. Rep. 145 (1854).

<sup>48</sup> The New York court held, for example, in *Gordon v. Nationwide Mut. Ins. Co.*, 30 N.Y.2d 427, 285 N.E.2d 849, 334 N.Y.S.2d 601 (1972), *cert. denied*, 410 U.S. 931 (1973), that the policyholder could recover damages for all detriment proximately caused by the insurer's breach of contract.

<sup>49</sup> *Reichert v. Gen. Ins. Co. of America*, 428 P.2d 860, 868, 59 Cal. Rptr. 724, 732 (1967), *vacated*, 68 Cal. 2d 822, 442 P.2d 377, 69 Cal. Rptr. 321 (1968).

<sup>50</sup> *Parks, Recovery of Extra-Contract Damages in Suits on Insurance Policies*, 9 FORUM 43, 58 (1973). In actions on contracts of common carriers, contracts for the disposition of corpses, and contracts for delivery of death messages, where the defendant has reason to know when the contract is entered that its breach will cause the plaintiff mental suffering for reasons other than financial loss, damages for mental anguish may be recovered. See Note, *Damages for Mental Suffering Caused by Insurers: Recent Developments in the Law of Tort and Contract*, 48 NOTRE DAME LAW. 1303 (1973).

The California court was among the first to consider an insurance contract to be "personal" rather than commercial, thus allowing recovery of damages for mental suffering in a contract action on an insurance policy.<sup>51</sup> Michigan also permits recovery of damages for emotional distress if the policy sued upon in the contract action involves "matters of mental concern or solicitude," such as a life insurance or disability policy.<sup>52</sup> However, these states are among a small minority of jurisdictions which award damages for mental suffering in suits against insurers for breach of contract.

Punitive or exemplary damages are also generally not recoverable in a contract action. The rationale for this rule stems from the distinction between compensation and punishment.

If the general purpose underlying the law of damages is to promote security and prevent disorder, . . . and breaches of contract do not cause as much resentment or other physical or mental discomfort as do wrongs called torts or crimes, then the remedies needed to prevent breaches of contract and satisfy the injured party are not as severe as those needed to punish the tortfeasor or criminal.<sup>53</sup>

In a contract action to recover payments due under an insurance policy, the West Virginia court traditionally limited the damages recoverable to the benefits specified in the contract plus interest.<sup>54</sup> However, recent case law supports the view that the insured could also recover additional compensatory damages incurred as a result of the insurer's breaching its contractual obligations to him or her. Such damages would be 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

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<sup>51</sup> *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 434, 426 P.2d 173, 179, 58 Cal. Rptr. 13, 19 (1967).

<sup>52</sup> *Seaton v. State Farm Life Ins. Co.*, 75 Mich. App. 252, 260, 254 N.W.2d 858, 862 (1977) (life insurance policy); *Kewin v. Massachusetts Mut. Life Ins. Co.*, 79 Mich. App. 639, 650, 263 N.W.2d 258, 263 (1977) (disability insurance policy).

<sup>53</sup> *Ledingham v. Blue Cross Plan for Hosp. Care*, 29 Ill. App. 3d 339, 344, 330 N.E.2d 540, 544 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75 (1976) (paraphrasing 5 A. CORBIN, CONTRACTS § 1077 at 437-38 (1964)).

<sup>54</sup> See, e.g., *Rubenstein v. Metropolitan Life Ins. Co.*, 118 W. Va. 367, 190 S.E. 531 (1937).

*time they made the contract, as the probable result of its breach.*<sup>55</sup>

Nevertheless, application of this rule will generally prevent an award of damages for mental suffering, and punitive damages are also not recoverable in a breach of contract action in West Virginia.<sup>56</sup>

An insurer's breach of contract by intentional and unreasonable refusal to honor the valid claim of a policyholder often amounts to tortious conduct. Such a refusal may be in bad faith, willful, or in reckless disregard of the insured's rights. Punitive damages should be awarded in such a case to punish the insurance company for its wrongdoing and to serve as an example for others in the insurance industry that such conduct, which is deleterious to society, will not be tolerated. Therefore, because the injured policyholder can rarely recover exemplary damages against an insurer, a contract remedy is inadequate.

### C. Tort Theories of Recovery

#### *Fraud*

The elements of fraud are: (1) a misrepresentation or concealment by the defendant (2) made with knowledge of its falsity (3) with intent to defraud the plaintiff, upon which the plaintiff (4) justifiably relied to (5) his detriment.<sup>57</sup> Fraud arises in two forms in the insurance context: fraud at the time the policy is issued (or fraud in the inducement to purchase the insurance) and fraudulent conduct in settling a claim (or fraudulent breach of the insurance contract).<sup>58</sup>

The difficulty with fraud actions, proof of fraudulent intent, is most evident in jurisdictions which require the policyholder to prove fraud in the inducement to enter the insurance contract. The insurer's intent not to pay does not usually become apparent until the insured files a claim. In many states, however, proof of

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<sup>55</sup> *Kentucky Fried Chicken of Morgantown, Inc. v. Sellaro*, 214 S.E.2d 823, 827 (W. Va. 1975) (quoting 22 AM. JUR. 2d *Damages* § 56 (1965)).

<sup>56</sup> See, e.g., *Short v. Grange Mut. Cas. Co.*, 307 F. Supp. 768 (S.D. W. Va. 1969).

<sup>57</sup> W. PROSSER, *THE LAW OF TORTS* § 105 at 635-86 (4th ed. 1971).

<sup>58</sup> Mann & Keitz, *Judicial Approaches to the Awarding of Extra-Contract Damages for Breach of Insurance Contracts*, 661 INS. L.J. 95, 100-01 (1978).

fraudulent intent at that stage is not adequate to support an allegation of fraud in the inducement and to permit recovery of damages.<sup>59</sup>

California's lower appellate courts have eased the plaintiff's burden in this regard. These courts have allowed the insurer's intent not to perform the contract to be inferred from its subsequent refusal to pay benefits to which the insured was entitled under a disability policy.<sup>60</sup> California's lower courts have also permitted recovery of punitive damages for fraud based entirely on the insurer's promise contained in the insurance policy to make payments if the insured becomes disabled.<sup>61</sup>

A West Virginia policyholder may seek redress against an insurer which wrongfully refuses to pay his first-party claim by bringing suit for fraud.<sup>62</sup> Damages recoverable in such an action include those for mental suffering and punitive damages in the proper case.

In pursuing this cause of action the insured need not prove fraud in the inducement to purchase the insurance policy, or "actual fraud." The West Virginia Supreme Court of Appeals has defined actual fraud as "deception, intentionally practiced, to induce another to part with property or to surrender some legal right, and which accomplishes the end designed."<sup>63</sup>

Instead the plaintiff-insured may recover in a fraud action against an insurer which wrongfully refuses to pay a valid claim at any time after the insurance contract is entered. Such conduct by the insurer would constitute "constructive fraud," defined by the West Virginia court as "a breach of legal or equitable duty, which, irrespective of moral guilt of the fraud feisor, the law declares fraudulent, because of its tendency to deceive others, to violate public or private confidence, or to injure public interests."<sup>64</sup>

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<sup>59</sup> Note, *FORDHAM L. REV.*, *supra* note 20, at 171.

<sup>60</sup> *Wetherbee v. United Ins. Co. of America*, 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1968).

<sup>61</sup> *Miller v. Nat'l American Life Ins. Co.*, 54 Cal. App. 3d 331, 126 Cal. Rptr. 731 (1976).

<sup>62</sup> See generally *Steele v. Steele*, 295 F. Supp. 1266 (S.D. W. Va. 1969); *Miller v. Huntington & Ohio Bridge Co.*, 123 W. Va. 320, 15 S.E.2d 687 (1941).

<sup>63</sup> *Miller v. Huntington & Ohio Bridge Co.*, 123 W. Va. at 334, 15 S.E. 2d at 695 (quoting *Moore v. Gregory*, 146 Va. 504, 131 S.E. 692 (1925)).

<sup>64</sup> *Id.*

The West Virginia insured's ability to recover damages against an insurance company for constructive fraud places upon him or her a considerably lighter burden of proof than plaintiffs in many other jurisdictions face when bringing a fraud action. Nonetheless, a presumption always exists in this state in favor of the defendant's innocence and honesty in a given transaction. The burden is on the plaintiff who alleges fraud to prove it by clear and distinct evidence.<sup>65</sup>

Allowing the insured to recover for the insurer's fraudulent conduct in settling a claim is equivalent to the cause of action authorized in several jurisdictions for fraudulent breach of contract.<sup>66</sup> The South Carolina court, for example, has shown great sensitivity toward insurer misconduct in cases decided on this theory, evidencing a tendency to construe any misbehavior as a "fraudulent act."<sup>67</sup>

A cause of action for fraudulent breach of an insurance policy is a more logical and adequate theory of recovery than fraud in the inducement to enter the contract, which may be nearly impossible to prove. The theory of fraudulent breach of contract bases the policyholder's recovery directly on the insurer's wrongdoing which caused the insured's detriment—improper refusal to pay a valid claim. Additionally, this theory permits recovery for all damages proximately caused by the insurance company's misconduct.<sup>68</sup> However, only a small number of jurisdictions recognize the independent tort of fraudulent breach of contract, possibly because they are unwilling to adopt a cause of action which blurs the distinction between contract and tort.

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<sup>65</sup> *Hunt v. Hunt*, 91 W. Va. 685, 114 S.E. 283 (1922).

<sup>66</sup> *See, e.g., Physicians Mut. Ins. Co. v. Savage*, 156 Ind. App. 283, 296 N.E.2d 165 (1973); *Blackburn v. Government Employees Ins. Co.*, 264 S.C. 535, 216 S.E.2d 192 (1975), in which the court applied a bad faith standard in holding the insurer liable for a fraudulent breach of contract for accepting the insured's premium payments while knowing that the policy did not include catastrophes against which the insured believed he was covered.

<sup>67</sup> Note, *Damages Assessed Against Insurers for Wrongful Failure to Pay*, 10 WM. & MARY L. REV. 466, 472 (1968). *See, e.g., Dawkins v. Nat'l Liberty Life Ins. Co.*, 252 F. Supp 800 (D.S.C. 1966); *Corley v. Coastal States Life Ins. Co.*, 244 S.C. 1, 135 S.E.2d 316 (1964).

<sup>68</sup> Note, *FORDHAM L. REV.*, *supra* note 20, at 173.

*Intentional Infliction of Emotional Distress*

The majority of states permit a tort action for intentional infliction of emotional distress<sup>69</sup> and require proof of the following elements in such an action: (1) outrageous conduct by the defendant; (2) the defendant's intentional causing of emotional distress or his or her reckless disregard of the probability of causing such distress; (3) severe or extreme mental distress suffered by the plaintiff; and (4) actual or proximate causation of the plaintiff's emotional distress by the defendant's conduct.<sup>70</sup>

The states first recognizing this cause of action in the first-party insurance context were California,<sup>71</sup> Illinois,<sup>72</sup> and Iowa.<sup>73</sup> Life and health insurers are particularly susceptible to an action under this theory, since their policyholders at the time of making claims are in emotion-charged situations. By combining a count charging intentional infliction of emotional distress with a count alleging a breach of the insurance contract, the insured may recover damages for mental distress plus the benefits due under the contract and perhaps consequential damages.

There is sound authority to support the view that because of the insurer's awareness of its policyholder's emotional vulnerability at the time a claim for loss is made, the insurer should be held to a higher standard of care. The drafters of the Restatement (Second) of Torts commented:

The extreme and outrageous character of the conduct may arise from the actor's knowledge that the other is peculiarly susceptible to the emotional distress, by reason of some physi-

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<sup>69</sup> See, e.g., *United Services Auto. Ass'n v. Glens Falls Ins. Co.*, 350 F. Supp. 869 (D. Conn. 1972); *World Ins. Co. v. Wright*, 308 So. 2d 612 (Fla. App. 1975); *Gibson v. Nat'l Ben Franklin Ins. Co.*, 387 A.2d 220 (Me. 1978); *Harris v. Jones*, 281 Md. 560, 380 A.2d 611 (1977); *Frishett v. State Farm Mut. Auto. Ins. Co.*, 3 Mich. App. 688, 143 N.W.2d 612 (1966); *Rockhill v. Pollard*, 259 Or. 54, 485 P.2d 28 (1971); *Drake v. Milwaukee Mut. Ins. Co.*, 70 Wis. 2d 977, 236 N.W.2d 204 (1975).

<sup>70</sup> RESTATEMENT (SECOND) OF TORTS § 46, at 71 (1965).

<sup>71</sup> *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970) (disability insurance policy).

<sup>72</sup> *Eckenrode v. Life of America Ins. Co.*, 470 F.2d 1 (7th Cir. 1972) (applying Illinois law).

<sup>73</sup> *Amsden v. Grinnell Mut. Reinsurance Co.*, 203 N.W.2d 252 (Iowa 1972), in which the court discussed in dicta the implied covenant of good faith and fair dealing in a first-party insurance contract.



cal or mental condition or peculiarity. The conduct may become heartless, flagrant, and outrageous when the actor proceeds in the face of such knowledge, where it would not be so if he did not know.<sup>74</sup>

This emotional vulnerability of the insurance claimant, coupled with the quasi-public nature of the insurance industry and the insurer's control over the interests of the insured, requires a standard of insurer misconduct far short of "outrage" in determining whether the insured should recover damages for intentional infliction of emotional distress.

In many states, however, the insured must prove that the insurer's conduct in refusing to pay his or her claim exceeded all bounds usually tolerated by a decent society.<sup>75</sup> Additionally, the insured must show that as a result he suffered severe mental distress.<sup>76</sup> Furthermore, the insurance company's settlement tactics may be privileged, whereby it will not be held liable for intentional infliction of emotional distress if it merely insists upon its legal rights in a permissible way.<sup>77</sup> The insured, therefore, faces a heavy burden of proof in pursuing an action against his or her insurer upon this theory.

West Virginia recognizes the tort of intentional infliction of emotional distress.<sup>78</sup> A policyholder bringing an action for an insurer's refusal to pay a claim under this theory must prove that his or her mental suffering resulted from the insurance company's intentional or wanton wrongful act.<sup>79</sup> The plaintiff need not allege that his or her emotional distress was severe, nor must the allega-

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<sup>74</sup> RESTATEMENT (SECOND) OF TORTS § 46, Comment f at 75 (1965).

<sup>75</sup> *Id.*, Comment d at 72 (1965).

<sup>76</sup> *Id.*, Comment j at 77 (1965), defines severe mental suffering to include "all highly unpleasant mental reactions, such as fright, horror, grief, shame, humiliation, embarrassment, anger, chagrin, disappointment, worry, and nausea."

<sup>77</sup> RESTATEMENT (SECOND) OF TORTS § 46, Comment g and Illustration 14 at 76 (1965); *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 395-96, 89 Cal. Rptr. 78, 89 (1970).

<sup>78</sup> *Prince v. Pittston Co.*, 63 F.R.D. 28 (S.D. W. Va. 1974); *Harless v. First Nat'l Bank in Fairmont*, 246 S.E.2d 270 (W. Va. 1978); *England v. Central Pocahontas Coal Co.*, 86 W. Va. 575, 104 S.E. 46 (1920); *Michaelson v. Turk*, 79 W. Va. 31, 90 S.E. 395 (1916), applying W. VA. CODE § 55-7-2 (1966), the state's "insulting words" statute.

<sup>79</sup> *Monteleone v. Co-Operative Transit Co.*, 128 W. Va. 340, 346-47, 36 S.E.2d 475, 478 (1945).

tions of mental suffering be corroborated by pecuniary losses.<sup>80</sup>

The West Virginia plaintiff may recover punitive damages in an action for intentional infliction of emotional distress.<sup>81</sup> However, by pursuing this type of suit the insured may be unable to recover actual damages for loss of equity in property which resulted from the insurer's failure to pay a valid claim. If, for example, the insured loses his or her home due to inability to make mortgage payments following the insurer's wrongful denial of the disability policy claim, he or she may not be awarded compensation for such a loss under this theory of recovery.

Before the advent of the tort of bad faith refusal by an insurer to pay first-party claims, intentional infliction of emotional distress was perhaps the most advantageous theory upon which to bring suit against an insurer, for three reasons. First, the insured need not prove any actual property or pecuniary loss to recover damages for mental suffering. Second, most jurisdictions recognizing this cause of action permit recovery of punitive damages against the insurance company. Third, once the insured establishes a prima facie case of intentional infliction of emotional distress, the insurer will have great difficulty in justifying its conduct.<sup>82</sup>

### *Strict Liability*

Several authors have commented that court decisions in various states have foreshadowed a rule of strict liability for an insurer's refusal to settle or pay a policyholder's claim.<sup>83</sup> Most of the cases cited for this proposition involve third-party (liability) insurance claims<sup>84</sup> rather than first-party (indemnity) claims. Impos-

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<sup>80</sup> *State Human Rights Comm'n v. Pearlman Realty Agcy.*, 239 S.E.2d 145 (W. Va. 1977).

<sup>81</sup> *Michaelson v. Turk*, 79 W. Va. 31, 37, 90 S.E. 395, 397 (1916).

<sup>82</sup> Note, *First Party Torts—Extra-Contractual Liability of Insurers Who Violate the Duty of Good Faith and Fair Dealing*, 25 *DRAKE L. REV.* 900, 914 (1976).

<sup>83</sup> See Comment, *The Emerging Fiduciary Obligations and Strict Liability in Insurance Law*, 14 *CAL. W.L. REV.* 358 (1978); Case Note, 12 *CAL. W.L. REV.* 591 (1976); Hirsch & Carpenter, *supra* note 8.

<sup>84</sup> See *Johansen v. California State Auto. Ass'n Inter-Ins. Bur.*, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975); *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967); *Koppie v. Allied Mut. Ins. Co.*, 210 N.W.2d 844 (Iowa 1973); *Rova Farms Resort, Inc. v. Investors Ins. Co. of America*, 65 N.J. 474, 323 A.2d 495 (1974).

sition of strict liability in the third-party insurance context may be appropriate when the insurer has failed to negotiate properly a settlement or defend its insured in court, thereby exposing its policyholder to a large judgment far in excess of policy limits. However, no court has implemented such a rule thus far.

A few lower appellate court cases in California have been interpreted as indicating a trend toward strict liability in first-party insurance.<sup>85</sup> The supreme court of that state has made it clear, however, that this is the era of bad faith.<sup>86</sup> A rule of strict liability should not be adopted in regard to first-party insurance, for this would abrogate the insurer's right to investigate and reject invalid claims. When debatable claims are submitted, the insurer has the undeniable right to question their legitimacy. Imposition of strict liability for all damages flowing from an insurance company's refusal to pay a claim, however spurious, would not properly balance the competing interests of insurer and insured in claims disposition.

### III. THE TORT OF BAD FAITH

The tort of bad faith evolved in California through a line of decisions culminating in *Gruenberg v. Aetna Insurance Co.*,<sup>87</sup> the first case allowing recovery of compensatory and punitive damages based on an insurer's bad faith refusal to pay a first-party claim. The elements that must be alleged and proven to establish a prima facie case of bad faith include: (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,"<sup>88</sup> and (4) damages resulting from the insurer's bad faith conduct.

The duty upon which this tort is predicated arises in some jurisdictions from an implied covenant of good faith and fair deal-

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<sup>85</sup> *Egan v. Mutual of Omaha Ins. Co.*, 133 Cal. Rptr. 899 (1976); *Jarchow v. Transamerica Title Ins. Co.*, 48 Cal. App. 3d 917, 122 Cal. Rptr. 470 (1975).

<sup>86</sup> *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

<sup>87</sup> *Id.*

<sup>88</sup> *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 691, 271 N.W.2d 368, 376 (1978).

ing in the insurance contract.<sup>89</sup> Other states' courts have construed statutes requiring an insurer to pay promptly the claims of its policyholder as giving rise to such a duty.<sup>90</sup> If the insurer breaches this duty by acting in bad faith toward its insured, the policyholder may bring a tort action in which he or she may recover compensatory damages for pecuniary loss and emotional distress, plus, in the appropriate case, punitive damages.

The genesis of this cause of action began in 1958, when the California court first applied the implied covenant of good faith and fair dealing to an insurance contract.<sup>91</sup> Nine years later, the court reaffirmed the insurer's implied-in-law duty and established a standard for the substantial damages recoverable for its breach in a third-party insurance case.<sup>92</sup> In 1970 a lower appellate court in California first discussed the independent tort of bad faith in regard to first-party insurance claims in a case pleaded as an action for the separate tort of intentional infliction of emotional distress.<sup>93</sup> The Supreme Court of California recognized the new cause of action three years later in the *Gruenberg* decision.

The facts in *Gruenberg* were as follows: the plaintiff was the owner of a cocktail lounge and restaurant which was destroyed in a fire. The defendants were three insurance companies from which the plaintiff had purchased fire policies. Following the blaze, the insurers hired an investigation firm to evaluate the plaintiff's claim. While at the burned-out restaurant, a claims adjuster for this firm stated to an arson inspector from the Los Angeles Fire Department that the plaintiff was overinsured.

Three days later criminal authorities charged the plaintiff with the felony of arson. These charges were subsequently dismissed for lack of probable cause. In the interim, however, the defendant insurance carriers retained a law firm to represent

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<sup>89</sup> See, e.g., *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973).

<sup>90</sup> See, e.g., *First Sec. Bank of Bozeman v. Goddard*, 593 P.2d 1040 (Mont. 1979), construing MONT. REV. CODES ANN. § 40-4213 (1961) [now MONT. CODE ANN. § 33-21-105].

<sup>91</sup> *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 (1958).

<sup>92</sup> *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).

<sup>93</sup> *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

them regarding the plaintiff's fire loss claim. A member of this firm demanded in writing that the plaintiff appear at the firm's office on a given date to produce certain documents and submit to an examination under oath. Because the arson charges were still pending at this time, his attorney advised the plaintiff not to make any statements concerning the fire loss.

When the plaintiff failed to appear at the office of the defendants' attorneys on the specified date, the insurance companies denied liability on his claim on the ground that he had violated the "notice and cooperation clause" in the fire insurance policies, thus voiding the coverage thereunder. After the state dropped the criminal charges against the plaintiff, his attorney advised the insurance carriers that the plaintiff was then willing to make himself available for an examination. The insurers reaffirmed their denial of the claim because of the plaintiff's earlier failure to appear.

The policyholder then filed a tort action against the insurance companies. The trial court dismissed the suit, and the plaintiff appealed. In his complaint, which did not include a count for breach of contract, the insured alleged that as a "direct and proximate result of the outrageous conduct and bad faith of the defendants," he suffered "severe economic damages," "severe emotional upset and distress," loss of earnings, and sundry special damages. The plaintiff sought punitive as well as compensatory damages. The court held that while this complaint was "far from a model pleading,"<sup>94</sup> it did allege a breach of a duty owed by the defendant insurance companies to their policyholder, the plaintiff.<sup>95</sup>

In *Gruenberg*, the Supreme Court of California held that the duty to accept reasonable settlements in a third-party insurance case and the duty not to withhold unreasonably payments due

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<sup>94</sup> 9 Cal. 3d 566, 575, 510 P.2d 1032, 1038, 108 Cal. Rptr. 480, 486 (1973).

<sup>95</sup> The insurance companies in *Gruenberg* sought to use the defense that their performance under the fire policies was excused because of the plaintiff's supposed breach of the contract for failure to comply with the cooperation clause in the policies. In response to this contention the court declared, "[W]e do not think that plaintiff's alleged breach excuses defendants from their duty, implied by law, of good faith and fair dealing. In other words, the insurer's duty is unconditional and independent of the performance of the plaintiff's contractual obligations." 9 Cal. 3d at 578, 510 P.2d at 1040, 108 Cal. Rptr. at 488.

under a first-party policy are but two different aspects of the same duty:

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.<sup>96</sup>

The court further held that the insured could recover for emotional distress as an element of damages in a bad faith cause of action, eliminating the requirement that the plaintiff's emotional distress be "severe" in order to support such a damage award. The *Gruenberg* court reasoned that since the plaintiff had suffered substantial pecuniary losses aside from any emotional distress, he was entitled to recover damages for mental suffering.<sup>97</sup> The court did not address the issue of punitive damages since the jury had not awarded such damages to the plaintiff.

The following year the tort of bad faith became firmly established in California with the decision in *Silberg v. California Life Insurance Company*.<sup>98</sup> The plaintiff here had purchased a disability policy from the defendant insurer. The insured severely injured his foot while making an inspection of his landlord's laundromat, where he had agreed to perform incidental services in return for a reduction in rent. Therefore, a question arose as to whether his injury was covered by workmen's compensation and thus expressly excluded from the coverage afforded by the insurance policy purchased from the defendant.

The insurance company refused to pay the plaintiff benefits pending disposition of his workmen's compensation claim, contending that by doing so it was following an established practice in the insurance industry. The insurer also defended its actions on the ground that it genuinely believed the plaintiff's policy as written did not cover the foot injury.

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<sup>96</sup> *Id.* at 573-74, 510 P.2d at 1037, 108 Cal. Rptr. at 485.

<sup>97</sup> *Id.* at 580, 510 P.2d at 1041-42, 108 Cal. Rptr. at 489-90.

<sup>98</sup> 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974).

The court rejected the defendant's arguments, holding that the scope of an insurer's duty of good faith and fair dealing cannot be circumscribed entirely by industry custom.<sup>99</sup> The court found that as a matter of law the insurance company had by its conduct breached this duty owed to the plaintiff. Compensatory damages of \$75,000 were thus properly awarded for the resulting detriment suffered by the insured, including his physical and mental distress.

In *Silberg* the jury also awarded the plaintiff \$500,000 in exemplary damages, and the recoverability of such damages was the principal issue in the case on appeal. The state supreme court ordered the case remanded for another trial on the punitive damages issue. Applying a statutory provision, the court held that recovery of such damages required a showing of oppression, fraud, or malice, with malice defined as "the intent to vex, injure or annoy, or with a conscious disregard of the plaintiff's rights."<sup>100</sup>

Subsequent to these first bad faith case decisions in California, courts in at least fourteen other jurisdictions have expressly recognized an independent tort for an insurer's breach of its duty of good faith and fair dealing in handling first-party claims.<sup>101</sup>

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<sup>99</sup> *Id.* at 462, 521 P.2d at 1109, 113 Cal. Rptr. at 717.

<sup>100</sup> *Id.*, 521 P.2d at 1110, 113 Cal. Rptr. at 718, applying CAL. CIV. CODE § 3294 (Deering 1972).

Several commentators have suggested that the *Silberg* holding represents a setback to the insured by restricting exemplary damages recoverable in a bad faith action against an insurer. See Hirsch & Carpenter, *supra* note 8, at 329, and Note, DRAKE L. REV., *supra* note 82, at 911.

A more recent decision by a California lower appellate court belies that assumption, however. In *Egan v. Mut. of Omaha Ins. Co.*, 133 Cal. Rptr. 899 (1976), a fire insurance case, the lower court held that intent to harm is not a prerequisite of bad faith conduct. The jury had awarded the plaintiff \$123,000 in compensatory damages and \$5 million in punitive damages, which the appellate court reduced by half on the ground that the huge exemplary damage award showed passion and prejudice by the jury. Nevertheless, the court's decision to allow the plaintiff to collect the remaining \$2.5 million hardly suggests any serious restriction on the insured's ability to recover punitive damages.

<sup>101</sup> *Battista v. Lebanon Trotting Ass'n*, 538 F.2d 111 (6th Cir. 1976) (applying Ohio law); *Carter v. Hartford Acc. & Indem. Co.*, 423 F. Supp. 827 (E.D. Va. 1976); *Escambia Treating Co. v. Aetna Cas. & Surety Co.*, 421 F. Supp. 1367 (N.D. Fla. 1976); *United Services Auto. Ass'n v. Werley*, 526 P.2d 28 (Alas. 1974); *Grand Sheet Metal Products Co. v. Protection Mut. Ins. Co.*, 34 Conn. Sup. 46, 375 A.2d 428 (1977); *Ledingham v. Blue Cross Plan for Hosp. Care*, 29 Ill. App. 3d 339, 330 N.E.2d 540 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75

Dicta in court opinions of several additional states have evinced a favorable view toward this new cause of action,<sup>102</sup> while only one jurisdiction has rejected the new tort.<sup>103</sup>

While aggravated instances of insurer misconduct characterized the original California bad faith cases, states recently recognizing this new cause of action have permitted suits against insurance companies which engaged in more subtle forms of wrongdoing. An example of this trend toward a more relaxed standard of what constitutes bad faith conduct by an insurer is *Anderson v. Continental Insurance Co.*,<sup>104</sup> a 1978 decision by the Supreme Court of Wisconsin.

In 1973, the Andersons purchased a homeowner's policy from the defendant insurance company which included coverage for loss due to fire, lightning, explosion, or smoke. Two years later the interior and contents of their home sustained smoke damage when an oil furnace caught fire or exploded. The following day the plaintiffs gave notice of the damage to the defendant insurer, which hired an adjusting company to handle the claim. This company called in cleaners who attempted to renovate the premises and contents of the policyholders' home. However, the plaintiffs had to repaint the interior of the house and replace carpeting which shrank due to the excessive cleaning ordered by the adjusting company.

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(1976); *Rex Ins. Co. v. Baldwin*, 163 Ind. App. 308, 323 N.E.2d 270 (1975); *First Sec. Bank of Bozeman v. Goddard*, 593 P.2d 1040 (Mont. 1979); *United States Fidelity & Guar. Co. v. Peterson*, 91 Nev. 617, 540 P.2d 1070 (1975); *State Farm Gen. Ins. Co. v. Clifton*, 86 N.M. 757, 527 P.2d 798 (1974); *Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co.*, 279 N.W.2d 638 (N.D. 1979); *Christian v. American Home Assurance Co.*, 577 P.2d 899 (Okla. 1978); *Diamon v. Penn Mut. Fire Ins. Co.*, 247 Pa. Sup. 534, 372 A.2d 1218 (1977); *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978).

<sup>102</sup> See, e.g., *Vincent v. Blue Cross-Blue Shield of Alabama, Inc.*, 373 So. 2d 1054 (Ala. 1979); *John Hancock Mut. Life Ins. Co. v. McNeill*, 27 Ariz. App. 502, 556 P.2d 803 (1976); *Findley v. Time Ins. Co.*, 573 S.W.2d 908 (Ark. 1978); *DiIorio v. Abington Mut. Fire Ins. Co.*, 402 A.2d 745 (R.I. 1979).

<sup>103</sup> In *Lawton v. Great Southwest Fire Ins. Co.*, 118 N.H. 607, 392 A.2d 576 (1978), the Supreme Court of New Hampshire refused to recognize a tort action for an insurer's bad faith in settling first-party claims. The court based its holding on the ground that an insurer, while owing a duty of good faith and fair dealing to liability policyholders in settling third-party claims against them, owes no such duty to its first-party (indemnity) policyholders.

<sup>104</sup> 85 Wis. 2d 675, 271 N.W.2d 368 (1978).



The plaintiffs attempted unsuccessfully to negotiate with the adjuster, as an agent of the defendant insurer, to be reimbursed for these restoration costs. They then retained an attorney, who immediately filed a proof of loss with the defendant insurance company detailing the loss claimed by the policyholders. For nearly two months the insurer and its agent, the adjusting company, shunted the plaintiffs' claim between their offices in Wisconsin and New York. The insurance company then returned the proof of loss to the plaintiffs' counsel without paying the claim. This prompted the policyholders to bring a court action against their insurer on a theory of bad faith.

The Supreme Court of Wisconsin held in *Anderson* that the plaintiffs had stated a cause of action for bad faith,<sup>105</sup> even though the defendant insurer's alleged misconduct did not rise to the level of wrongdoing displayed by the insurance company in *Gruenberg*. As a *quid pro quo* for permitting a bad faith action upon a lesser showing of insurer malfeasance, however, the *Anderson* decision set forth two rules restricting certain damages recoverable in a bad faith suit. The court held that a policyholder cannot recover damages for mental suffering inflicted by an insurer unless his emotional distress is severe.<sup>106</sup> Furthermore, the court approved an award of punitive damages in a bad faith action only upon "a showing of an evil intent deserving of punishment or of something in the nature of special ill-will or wanton disregard of duty or gross or outrageous conduct."<sup>107</sup>

In addition to adopting a different set of damage rules applicable to a bad faith suit, the court in *Anderson* also departed somewhat from the theory underlying this cause of action as it was enunciated in the early California bad faith cases. The Wisconsin court clarified the distinction between the insurer's breach of its contractual duty to its insured and breach of its duty of good faith and fair dealing. The court criticized the use of the label "tortious breach of contract,"<sup>108</sup> observing:

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<sup>105</sup> *Id.* at 684, 271 N.W.2d at 373.

<sup>106</sup> *Id.* at 696, 271 N.W.2d at 378.

<sup>107</sup> *Id.* at 697, 271 N.W.2d at 379.

<sup>108</sup> "Tortious breach of contract" is the term the Supreme Court of Mississippi has chosen to denominate the tort action an insured may maintain for an insurer's wrongful failure to pay a first-party claim. In *Travelers Indem. Co. v. Wetherbee*, 368 So. 2d 829 (Miss. 1979), the court recognized an independent tort for the insurer's intentional withholding of benefits due under a fire insurance policy and

While that term may be a convenient shorthand method of denominating the intentional conduct of a contracting party when it acts in bad faith to avoid its contract obligations, it is confusing and inappropriate, because it could lead one to believe that the wrong done is the breach of the contract. It obscures the fact that bad faith conduct by one party to a contract toward another is a tort separate and apart from a breach of contract *per se* and it fails to emphasize the fact that *separate damages may be recovered for the tort and for the contract breach.*<sup>109</sup>

This distinction is especially significant in regard to the recovery of punitive damages, which are generally not awarded for a breach of contract. The question of whether exemplary damages are recoverable in a bad faith action cannot be disposed of upon the assertion by the insurer that the insured is alleging a breach of contract. Instead the punitive damages issue must be considered in light of "whether the facts surrounding the tort of bad faith evidence such conduct that punitive or exemplary damages are permissible."<sup>110</sup>

Two types of standards are used in determining whether an insurer has acted in bad faith toward its insured. Some courts apply an objective test based on whether a reasonable insurance company in like or similar circumstances would have denied the claim.<sup>111</sup> Other jurisdictions adopt a dual standard: an objective test of whether a reasonable insurer would engage in such conduct, and a subjective test of whether the particular insurance company knew or reasonably should have known that its conduct would result in harm to its insured.<sup>112</sup>

In applying the objective standard for determining whether the insurer has acted in bad faith, the court must consider whether the insurance company properly investigated the policyholder's claim and afforded the results of that investigation a reasonable evaluation and review.<sup>113</sup> Guidelines on what constitutes

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approved an award of punitive damages.

<sup>109</sup> 85 Wis. 2d at 686, 271 N.W.2d at 374 (emphasis added).

<sup>110</sup> *Id.* at 687, 271 N.W.2d at 374.

<sup>111</sup> See, e.g., *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978).

<sup>112</sup> See, e.g., *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

<sup>113</sup> 85 Wis. 2d at 692, 271 N.W.2d at 377.

reasonable investigative and claims handling techniques by insurance companies may be found in unfair claims practices or unfair trade practices statutes enacted in many states. "Juries should have no more difficulty in recognizing the bad faith insurer than in recognizing the reasonably prudent person in negligence actions."<sup>114</sup>

For a policyholder whose first-party claim has been wrongfully denied, bringing a bad faith action against his or her insurer has several advantages over other tort theories. Unlike a fraud action, a bad faith suit does not require a showing of fraud in the inducement to enter the insurance contract. An action for breach of the insurer's duty of good faith and fair dealing embraces the theory of fraud<sup>115</sup> while permitting recovery upon proof of the insurer's wrongdoing at the time a claim is made and unreasonably denied. Furthermore, mental distress is only one element of damages sought in a bad faith suit, rather than being the basis of the tort as with an action for intentional infliction of emotional distress. In many jurisdictions, except Wisconsin, the plaintiff may be compensated for mental anguish without showing that his or her emotional distress was severe or that the insurer's conduct was outrageous.<sup>116</sup>

The most controversial aspect of the tort of bad faith is the recovery of large punitive damage awards allowed by many state courts which recognize this cause of action. Due to the vast financial resources of insurance companies, exemplary damage awards against these entities must necessarily be large in order to punish an insurer sufficiently for its wrongdoing.<sup>117</sup> It is an established rule in many jurisdictions that the jury may consider the pecuniary condition of a defendant in determining the amount of punitive damages necessary for his adequate punishment.<sup>118</sup>

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<sup>114</sup> Note, *FORDHAM L. REV.*, *supra* note 20, at 180.

<sup>115</sup> In *Escambia Treating Co. v. Aetna Cas. & Sur. Co.*, 421 F. Supp. 1367 (N.D. Fla. 1976), for example, the court held that while the facts of the case did not support a fraud claim, the plaintiff did state a cause of action for bad faith against the defendant insurer.

<sup>116</sup> Note, *FORDHAM L. REV.*, *supra* note 20, at 180.

<sup>117</sup> See, e.g., *Standard Life Ins. Co. of Indiana v. Veal*, 354 So. 2d 239 (Miss. 1977), in which the court upheld a \$25,000 punitive damage award against an insurance company with assets in excess of \$85 million which had denied a legitimate claim with no reason.

<sup>118</sup> See, e.g., *Hess v. Marinari*, 81 W. Va. 500, 94 S.E. 968 (1918).

As a deterrent to abusive tactics used by insurers in delaying or denying payment of valid claims, an award of exemplary damages is the only viable remedy. The threat of its policyholder collecting high punitive damages in a bad faith action should discourage an insurer from employing groundless excuses in an attempt to escape liability for payments due under an insurance contract.

Obviously, courts should not award punitive damages so as to infringe upon the insurer's right to disagree with the claimant as to the amount of benefits due under a policy. The judiciary must take care not to dissuade insurers from adjudicating honest disputes over claims, even if the insurer is in error and the litigation harms the opposing party. An insurance company should not be exposed to an award of exemplary damages for attempting in good faith to pay only the amounts required under the provisions of a policy.

It has been argued that insurance companies which must pay huge sums as punitive damages will pass this cost along to the public in the form of higher premiums. If this in fact occurs, punishment and deterrence of the insurer's wrongdoing will not be achieved. However, exemplary damages may still serve a valuable function. Insurers who act fairly and in good faith in handling claims will not have to pay large punitive damage awards. These companies may thus have larger profit margins, which will encourage insurers to avoid bad faith conduct giving rise to exemplary damage awards.<sup>119</sup> An insurance company's management personnel are responsible to directors and shareholders, who will not tolerate practices which result in high punitive damages being assessed against the company.

In addition to criticism that the tort of bad faith promotes runaway exemplary damage awards, opponents of this cause of action have contended that recognition of this tort forces insurers to "pay all claims and investigate afterwards, assuming, of course, payment doesn't waive that right."<sup>120</sup> This eventuality has not occurred, however, in jurisdictions allowing actions for an insurer's bad faith. Courts in these states have upheld, for example, the

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<sup>119</sup> Comment, 15 SAN DIEGO L. REV. 287, 307 (1978).

<sup>120</sup> Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 592, 510 P.2d 1032, 1049, 108 Cal. Rptr. 480, 497 (1973) (dissenting opinion).

insurer's right (albeit duty) to thoroughly investigate a claim<sup>121</sup> and to seek a declaratory judgment on whether it is liable for paying a disputed claim.<sup>122</sup> One court has held that an insurance company which denied a claim in the mistaken belief that it was not covered by the policy was liable only for the policy benefits plus interest.<sup>123</sup>

Conversely, the insurer should have no right to rely on groundless defenses in denying a valid claim,<sup>124</sup> to evade its statutory duty of making payments as soon as possible,<sup>125</sup> or to file a criminal charge against a policyholder for attempting to cheat the insurance company without first investigating the insured's claim.<sup>126</sup> Adoption of a tort cause of action for bad faith most adequately recompenses a policyholder who has been the victim of such tactics.

#### IV. RECOGNITION OF THE TORT OF BAD FAITH IN WEST VIRGINIA

The West Virginia Supreme Court of Appeals has never been presented with a first-party insurance case brought on the tort theory of bad faith.<sup>127</sup> In *Speicher v. State Farm Mutual Automobile Insurance Co.*,<sup>128</sup> the court was faced with deciding whether an insurer owes a duty of due care or good faith to its liability policyholder in negotiating pre-trial settlements of third-party

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<sup>121</sup> See, e.g., *Anderson v. Continental Ins. Co.*, 85 Wis. 2d 675, 271 N.W.2d 368 (1978).

<sup>122</sup> See, e.g., *State Farm Gen. Ins. Co. v. Clifton*, 86 N.M. 757, 527 P.2d 798 (1974); *Christian v. American Home Assur. Co.*, 577 P.2d 899 (Okla. 1978).

<sup>123</sup> *Ledingham v. Blue Cross Plan for Hosp. Care*, 29 Ill. App. 3d 339, 330 N.E.2d 540 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75 (1976).

<sup>124</sup> See *United Services Auto. Ass'n v. Werley*, 526 P.2d 28 (Alaska 1974).

<sup>125</sup> See *First Sec. Bank of Bozeman v. Goddard*, 593 P.2d 1040 (Mont. 1979).

<sup>126</sup> See *Diamon v. Penn Mut. Fire Ins. Co.*, 247 Pa. Super. 534, 372 A.2d 1218 (1977).

<sup>127</sup> If such a suit were filed in a trial court in West Virginia, enabling statutes would permit the question whether the tort of bad faith is recognized in West Virginia to be certified to the state supreme court of appeals. Under W. VA. CODE § 58-5-2 (Cum. Supp. 1979), a circuit court could certify this question to the supreme court if, for example, the defendant challenged the sufficiency of the complaint or moved for judgment on the pleadings. If a bad faith action involving first-party insurance were brought in a federal district court in West Virginia, under W. VA. CODE § 51-1A-1 (Cum. Supp. 1979) the court could certify the question to the state supreme court of appeals due to a lack of controlling precedent on the issue in this jurisdiction.

<sup>128</sup> 151 W. Va. 292, 151 S.E.2d 684 (1966).

claims against its insured. Here the court held that it need not reach the issue of the duty owed by the insurer, since upon the facts of the case the defendant insurer had acted neither negligently nor in bad faith.<sup>129</sup> The insurance company had thoroughly investigated the claims against the plaintiff-insured and had made several reasonable settlement offers to the third-party claimants, who insisted on pursuing the case to trial. The Fourth Circuit Court of Appeals subsequently held that under West Virginia law, an insurer owes a combined duty of good faith and due care in disposing of third-party claims.<sup>130</sup>

In *Speicher*, the West Virginia Supreme Court of Appeals did not reject the premise that a duty of good faith exists in the context of third-party insurance claims. It held only that the facts of that case showed no lack of good faith or due care by the defendant insurer. The *Speicher* decision therefore presents no obstacle to the court's future recognition of the insurer's duty of good faith and fair dealing in the first-party context, the breach of which would give rise to a tort cause of action.

Support for awarding extracontractual damages against insurers who wrongfully delay policy benefit payments can be found in Justice Neely's concurring opinion in *Jarrett v. E. L. Harper & Son, Inc.*,<sup>131</sup> a 1977 case involving destruction of the plaintiffs' water well due to the defendant's negligence. The court held in *Jarrett* that annoyance and inconvenience are proper elements of damages recoverable for injury to real property.<sup>132</sup> In his concurrence Justice Neely stated that this rule probably also applies as well to damages for injury to personalty. He then advocated a policyholder's recovery of damages for annoyance and inconvenience against automobile insurers who fail to settle claims quickly in reliance upon the proposition that insureds cannot realistically sue them for property damage. Justice Neely also cited fire insurance companies, which frequently deny the claims of their own policyholders, as appropriate targets for extracontractual damage awards if they deny or delay payment of legitimate claims.<sup>133</sup>

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<sup>129</sup> *Id.* at 301, 151 S.E.2d at 689.

<sup>130</sup> *Daniels v. Horace Mann Mut. Ins. Co.*, 422 F.2d 87 (4th Cir. 1970) (applying West Virginia law).

<sup>131</sup> 235 S.E.2d 362 (W. Va. 1977).

<sup>132</sup> *Id.* at 366.

<sup>133</sup> *Id.*

Bad faith is an intentional tort which must be proven on the basis of affirmative acts of the insurer amounting to a breach of its duty of good faith and fair dealing. If this cause of action is recognized in West Virginia, punitive damages may be recovered in a bad faith suit,<sup>134</sup> with the requirement that such damages may be awarded only in addition to compensatory or actual damages.<sup>135</sup>

In West Virginia an award of punitive damages may be in an amount as will be sufficient, together with the compensatory damages awarded against him or her, to punish the defendant for his or her wrongdoing and discourage others from committing similar offenses.<sup>136</sup> The jury may consider the station of the parties and the financial condition of the defendant in determining what will be an adequate award of exemplary damages.<sup>137</sup>

These rules could result in large damage verdicts being returned against insurers if the tort of bad faith were recognized in this state. However, the possible threat of huge punitive damages being awarded against insurance companies is weakened by the West Virginia rule that exemplary damages, if awarded, must bear some reasonable proportion to compensatory damages.<sup>138</sup> The West Virginia Supreme Court of Appeals has never precisely defined what is such a "reasonable proportion." It apparently is a standard somewhere between a two-to-one ratio of punitive damages to compensatory damages<sup>139</sup> and a ten-to-one ratio.<sup>140</sup>

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<sup>134</sup> See generally *Addair v. Huffman*, 156 W. Va. 592, 195 S.E.2d 739 (1973); *Horn v. Bowen*, 136 W. Va. 465, 67 S.E.2d 737 (1951); *Hurxthal v. St. Lawrence Boom & Lumber Co.*, 53 W. Va. 87, 44 S.E. 520 (1903).

<sup>135</sup> *Spencer v. Steinbrecher*, 152 W. Va. 490, 164 S.E.2d 710 (1968).

<sup>136</sup> *Ennis v. Brawley*, 129 W. Va. 621, 41 S.E.2d 680 (1947); *Peck v. Bez*, 129 W. Va. 247, 40 S.E.2d 1 (1946); *McCoy v. Price*, 91 W. Va. 10, 112 S.E. 186 (1922).

<sup>137</sup> *Pendleton v. Norfolk & W. Ry. Co.*, 82 W. Va. 270, 95 S.E. 941 (1918); *Hess v. Marinari*, 81 W. Va. 500, 94 S.E. 968 (1918).

<sup>138</sup> *Addair v. Huffman*, 156 W. Va. 592, 195 S.E.2d 739 (1973); *Spencer v. Steinbrecher*, 152 W. Va. 490, 164 S.E.2d 710 (1968); *Toler v. Cassinelli*, 129 W. Va. 591, 41 S.E.2d 672 (1946); *Newman v. Robson & Prichard*, 86 W. Va. 681, 104 S.E. 127 (1920); *Hess v. Marinari*, 81 W. Va. 500, 94 S.E. 968 (1918).

<sup>139</sup> *Turk v. Norfolk & W. Ry. Co.*, 75 W. Va. 623, 84 S.E. 569 (1915), holding that the facts of the case, a wrongful death action, justified an award of \$500 compensatory and \$1,000 punitive damages.

<sup>140</sup> *Pendleton v. Norfolk & W. Ry. Co.*, 82 W. Va. 270, 95 S.E. 941 (1918), holding that an award of \$557.50 compensatory damages and \$5,000 punitive damages was not reasonably proportional.

The West Virginia Supreme Court of Appeals has shown a liberal bent toward consumer protection in recent decisions.<sup>141</sup> It seems safe to predict that the court, if presented with an opportunity to recognize the new cause of action, would be willing to follow the California rule and adopt the tort of bad faith for the benefit of the insured public.

## V. CONCLUSION

A policyholder purchases insurance coverage to obtain both financial security and peace of mind. The insured pays premiums in the expectation that if he or she suffers a loss covered by his or her policy, the insurance company will act promptly to investigate and pay his or her claim. If the insurer wrongfully denies or delays payment of a valid claim, its actions may severely endanger the policyholder's economic and emotional well-being.

Existing judicial and statutory remedies in many jurisdictions are inadequate to prevent abusive practices by insurance companies or to compensate an insured who has suffered harm because he or she was not paid the policy benefits which were due. Mere contractual damages, even in states permitting the policyholder to recover for some of the consequential harm resulting from an insurer's misconduct, are clearly insufficient to compensate the insured fully. While actions for fraud and intentional infliction of emotional distress are often available to an injured policyholder, these bases of recovery cast a heavy burden of proof on the insured to show a heightened form of wrongdoing by the insurer before he or she can collect damages. The more subtle forms of insurance company misconduct, which nonetheless deny the insured the protection he or she has paid for, may not be redressed by these remedies.

The judiciary must take into account the interests of the insurance industry, the individual, and society in resolving this problem. The most appropriate solution is recognition of the tort

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<sup>141</sup> For example, in *Teller v. McCoy*, 253 S.E.2d 114 (W. Va. 1978), the court held that every residential lease contains an implied warranty of habitability, thus holding landlords legally liable for failure to maintain safe, fit rental housing units. Additionally, the court in *Morningstar v. Black & Decker Mfg. Co.*, 253 S.E.2d 666 (W. Va. 1979) adopted the rule of *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1963), imposing strict liability for defective products.



of an insurer's bad faith refusal to pay legitimate first-party claims. The theory underlying this cause of action does not abridge an insurance company's right to investigate and deny fraudulent claims or those excluded from policy coverage. If the insurer does not act fairly and in good faith, however, the policyholder who is harmed as a result can be most adequately compensated by using a bad faith theory of action.

As initially noted in this article, the current status of the law in many states encourages an insurer to delay unreasonably and unfairly payment of its policyholder's claim.

[T]he consumer is generally entitled to protection, and particularly to receive from his insurance company whatever he reasonably thought he was buying. . . . [T]he protection the law affords must be realistic. . . . [The insured] doesn't really get what he reasonably expected if [policy benefits are paid] only after years of battling the inarguably superior resources of the company, deducting sometimes-monstrous contingent fees and always-irksome costs, and frequently weathering a plentitude of abuse and harrassment in the bargain.

. . . .  
. . . The company has everything to gain by fighting The Bad Fight and nothing to lose but interest on its just obligation.<sup>142</sup>

Recognition of the tort of bad faith best remedies this inequity. Successful litigation of bad faith actions will bring insurers' abuses to the attention of the courts, the legislatures, and the public, thereby destroying the climate in which such wrongdoing may now flourish.<sup>143</sup>

Linda Gay

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<sup>142</sup> Lascher, *The Imposition of Punitive Damages in the Enforcement of Insurance Contracts*, 1971 ABA PROCEEDINGS, ABA SECTION OF INSURANCE, NEGLIGENCE AND COMPENSATION LAW 220, 220-21.

<sup>143</sup> Shernoff & Blickenstaff, *Investigating for Bad Faith: The Role of Plaintiff's Attorney*, 14 FORUM 132, 141 (1978).