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This survey of bad faith insurance law, 2007–2009, describes trends in court decisions regarding issues related to insurers’ rights in claims handling.

Room to Breathe: The “Return” of the Insurer’s Right of Discretion in Claims Handling

C.J. HADDICK, ESQ.

To the extent that the last several years have yielded any trends in the area of insurance bad faith law, there may be seen a movement in published decisions toward giving insurance company claims departments more discretion in handling claims, not less. This discretion has been granted in decisions by both state and federal courts, largely in three ways: 1) limiting the scope and reach of state bad faith statutes to a narrow range of insurer activity; 2) pruning back other legislation from applying to insurance bad faith cases (frustrating, to some extent, attempts by the plaintiffs’ trial lawyers’ bar to use such statutes in other bad faith litigation); and 3) endorsing of certain specific insurer claims

practices as being “within bounds” of legitimate insurer business activity, such that in undertaking such practices, an insurer is not normally liable for bad faith, absent other aggravating circumstances. This article examines this phenomenon, first in Pennsylvania and then in other states.

Why “Return” May Be a Misnomer

Admittedly, to say that there has been a “return” of the right of discretion to insurer claims departments may be to suggest too strongly that the right of discretion has ever been absent. The truth, of course, is that the insurer’s right of discretion in the

claims handling process has never been absent, in Pennsylvania or anywhere else.¹ Perhaps, it is better to say that the trend in insurance bad faith decisions from 2007–2009 has been to reinforce and enlarge, in certain areas, the right of insurer discretion.

In this article, we will first examine significant insurance bad faith decisions from the Commonwealth of Pennsylvania over the last several years. We will do this as a means of examining the general trend in insurance bad faith law in a concentrated and distilled form. Following that examination, we will turn our attention to specific aspects of insurance claims practices and aspects of claims handling, and in so doing, we will examine decisions from 2007–2009 in other states to see what conclusions might be drawn about larger-picture trends in insurance bad faith law and the impact on how insurers factor those trends into their claims-handling operations. We will also offer some observations about what the near future may hold.

Survey of Pennsylvania Bad Faith Decisions 2007–2009

A number of cases decided in Pennsylvania have had an impact on the bad faith landscape.

Toy v. Metropolitan Life Ins. Co. (Pa. 2007)

In *Toy*,² the Pennsylvania Supreme Court affirmed a summary judgment entered in favor of Metropolitan Life in a bad faith claim. Chief Justice Cappy, on behalf of the majority, considered, as part of his analysis, whether there was a remedy under Pennsylvania's bad faith statute for deceptive or unfair practices with respect to the sales of an insurance policy. In so doing, he devoted a substantial amount of time to reviewing the development and evolution of both common law and statutory bad faith in Pennsylvania, including the meaning that the particular term "bad faith" has acquired.

The majority of the court found that the term "bad faith" encompassed any frivolous or unfounded *refusal to pay the proceeds of the policy*. It did not find that the term went further, such as, for example, to be applicable to the business of insurance, which included the marketing and sales of policies. Cappy wrote:

We can only conclude on the question before us that the words in the statute are clear and

explicit and that the legislature intended not to give relief under the Bad Faith Statute to an insured who alleges that his insurer engaged in unfair or deceptive practices in soliciting the purchase of the policy.³

Toy, then, signaled a clear direction on the part of Pennsylvania's highest appeals court to narrow, rather than expand, the reach and breadth of the Pennsylvania bad faith statute (42 Pa.C.S.A. § 8371).

Ash v. Continental Ins. Co. (Pa. 2007)

In *Ash v. Continental Ins. Co.*,⁴ the Pennsylvania Supreme Court was called upon to assess the proper starting time for the two-year statute of limitations period in a case brought under the state's bad faith statute.⁵ In so doing, however, it also expressed the viewpoint that may have led the way for appellate cases that followed, narrowing the scope of Pennsylvania's bad faith statute. Specifically, and consistent with the wording of the statute conferring rights only to insureds and imposing liability only on insurers, the *Ash* court held that the terms of the bad faith statute provide a cause of action only for bad faith conduct of an insurer and created an action only for conduct "arising under an insurance policy."⁶ This would, of necessity, exclude any bad faith claims premised upon the failure to procure or sell a policy.⁷

The *Ash* court, then, viewed a bad faith dispute as a limited one. Bad faith, under the analytical model set up under *Ash*, was an adversarial tort, but one which applied only to a narrow area of insurer conduct (claims) and only in a narrow set of circumstances (claims arising under a policy of insurance). That the insured-insurer relationship could become adversarial was not a new concept in Pennsylvania law: The state's intermediate appellate court had, a year earlier, already ruled that where an insured made an uninsured motorist/underinsured motorist (UM/UIM) claim against her insurer and the parties proceeded to arbitration, that proceeding was adversarial.⁸

In just the span of these two state Supreme Court cases, bad faith actions under the Pennsylvania statute were limited to relations between insurer and insured arising under the insurance policy itself and only for claims arising under such a policy and not for other areas of the insurer-insured relationship, such as, e.g., the sales or placement of policies.^{9,10}

Other Significant Pennsylvania Decisions Regarding Claims Practices, 2007–2009

A number of appellate decisions in Pennsylvania over the last several years have given insurers room within which to defend themselves.

Zappile v. Amex Assurance (2007)

One of the most notable cases in the last three years was *Zappile v. Amex Assurance*.¹¹ In *Zappile*, an insured brought an action against his insurer for the bad faith handling of an underinsured motorist claim. After the Philadelphia Court of Common Pleas entered judgment in favor of the insured, the insurer appealed. The Pennsylvania Superior Court reversed, and in so doing, solidified the court's action of a year earlier in *Condio v. Erie Insurance Exchange*,¹² one of the more significant attempts in the last number of years to place insurers and insureds on equal footing in bad faith litigation. In *Condio*, the Pennsylvania Superior Court reversed a bad faith award against Erie Insurance and entered judgment as a matter of law in favor of Erie, holding, among other things, that UM/UIM arbitration proceedings between insurer and insured are adversarial and, as such, an insurer was well within bounds to protect its interests in such proceedings and to express doubts about the veracity of its insured's injury, if there was a reasonable basis to do so.

In *Zappile*, the insured's attorney made a UM/UIM policy limits demand of \$150,000 for his client, a pedestrian who sustained soft tissue knee and shoulder injuries after being struck by an underinsured vehicle. The tortfeasor tendered her policy limits of \$15,000, and Erie, the UIM insurer, offered \$32,000. The parties never agreed on a settlement number and proceeded to arbitration, at which the arbitrators entered a gross award of \$105,000 to the insured and his wife.

The insured brought a bad faith suit, premised upon the alleged bad faith undervaluation and resulting offer of \$32,000 in the UM/UIM claim. In reversing the trial court's judgment against the insurer in the bad faith case, based in part on the settlement offer, the Superior Court held that bad faith requires clear and convincing proof that the insurer's action lacked any reasonable basis and that the insurer recklessly disregarded a lack of reasonable basis to deny a claim. Second, the court found that mere negligence or bad judgment is not bad faith and that a finding of bad faith requires some dishonest purpose, motive

of self-interest, or ill will on the part of the insurer. The court also affirmed perhaps the most important holding from *Condio*, again recognizing UIM claims as adversarial.¹³

The court in *Zappile* also made significant pronouncements regarding an insurer's duty in relation to payment and settlement. The court held that an insurer has no duty to make partial payments for undisputed amounts in the midst of a contested claim and that an insurer retained full rights to question and contest the value of an injury in such a circumstance.¹⁴ And in what might have been the single most significant bad faith ruling of the year, the court ruled that wherefor the insured's lawyer's demand for the UM/UIM policy limits was never reduced, there was no bad faith on the part of the insurer for failing to negotiate against itself or increase its offer, going so far as to hold that the mere fact that the insurer had additional settlement monies available that it did not offer could not be clear and convincing evidence of bad faith against the backdrop of the plaintiff's policy-limits-only demand.¹⁵ Moreover, the court in *Zappile* said that it could not find as a basis for bad faith either strained communications or a "heightened level of distrust" between the parties.^{16, 17}

Principles Gleaned From Zappile

Thus, an insurer is privileged under Pennsylvania law to defend itself, even aggressively, in bad faith litigation, without fear of violating 42 Pa.C.S.A. § 8371.¹⁸ To the extent that a laundry list of principles can be gleaned from *Zappile*, it includes the following.

- The bad faith statute does not "require an insurer to sacrifice its own interests by blindly paying each and every claim submitted by an insured in order to avoid a bad faith suit."
- Insurers are within their rights to express doubts regarding a claim based upon investigation.
- Low but reasonable offers are not actionable.
- Insurers are granted deference when making decisions informed by law, such as laws regarding UM/UIM, that are in a state of flux.
- Insurers are entitled to change their minds and decisions based on ongoing investigation.

- Insurers are entitled to their own views concerning a proper neutral arbitrator.
- The plaintiff's burden in a bad faith case is an extraordinarily heavy one of providing clear and convincing evidence.
- An insurer may rely on a single piece of evidence, such as a police report, without being in bad faith.
- An insured's notice to its insurer of a "potential" claim triggers no duties or clocks on the part of the insurer.
- An insurer is entitled to retain and utilize experts to take positions contrary to the insured's without being in bad faith.
- An insurer may treat its insured as an adversary in a UM/UIM claim without committing bad faith.
- UM/UIM claims are inherently arm's length and adversarial.
- An insurer is entitled to employ counsel to act to protect the insurer's interest without committing bad faith.
- A UM/UIM investigation can no longer follow a "normal course" after an adversarial demand for arbitration by an insured.
- Simple passage of time is no longer always and in every case attributable to delay of the insurer or the insurer's counsel as a given.¹⁹

Thus, insurers do not commit bad faith simply by investigating claims or by having opinions on the value of claims that differ from that of their insureds. In fact, an insurer is permitted, as a matter of law, to "aggressively investigate and protect its interests" without running afoul of the bad faith statute.²⁰

Allison v. Allstate Indemnity Company

In *Allison v. Allstate Indemnity Company*,²¹ the Eastern District Court of Pennsylvania reaffirmed that all of the following would indicate that an insurer undertook a substantial and proper investigation of

the insurance claim at issue in that case: resolution of credibility problems via interviews and recorded statements, inspection of the property in question, and retention of an expert in a causation dispute regarding wind damage versus water damage.²² Thus, the use of such methods in the legitimate contexts of investigating a questioned and disputed insurance claim would appear to have support in common law.

Employers Mutual v. Loos:

Violations of Regulations and Guidelines

How are insurer violations of claims regulations, or even of the insurer's own internal guidelines, to be handled within the context of bad faith claims? While not without exception, the general trend in Pennsylvania over the last several years has been that the violation of unfair insurance or trade practices laws was not tantamount, or even necessarily germane, to proof of an insurer's bad faith liability. In *Employers Mutual v. Loos*,²³ the United States District for the Western District of Pennsylvania reasoned that such a possible violation of the state's Unfair Insurance Practices Act had no place in bad faith litigation because "a failure to comply [with the Pennsylvania Unfair Insurance Practices Act], may be equally consistent with a mistake as with bad faith."²⁴ Other cases both inside and outside the Western District have followed suit.²⁵

Stacey Smith, et al. v. Continental Casualty Co.

In *Stacey Smith, et al. v. Continental Casualty Co.*,²⁶ Continental denied a disability insurance claim in reliance on a policy exclusion, without first speaking to the insured. The insured raised the insurer's failure to speak with its insured prior to issuing the denial as constituting, in part, the basis for the bad faith claim. In affirming the judgment in favor of the insurer on the bad faith claim, the U.S. Court of Appeals for the Third Circuit held that even if the insurer's failure to speak with an insured before denying a claim in reliance on a clear and unambiguous exclusion violated best practices, such a failure did not constitute bad faith within the meaning of Pennsylvania first-party bad faith law.

Employers Mutual v. Loos:

Reliance on Policy Provisions

Pennsylvania courts have also held, as a matter of law, that it is not bad faith for an insurer to ask that

the insured abide by the policy terms agreed upon or to reasonably rely upon clear policy provisions in dealing with its insured.²⁷ This right on the part of the insurer has been protected, and the insurer, as a result, shielded from bad faith liability, even if such reliance turns out to be wrong:

Under Pennsylvania law, the presence or absence of bad faith does not turn on the legal correctness of the basis for an insurer's denial of an insured's claim. *Jung v. Nationwide Mutual Fire Ins. Co.*, 949 F. Supp. 353, 359–360, n. 7 (E.D. Pa. 1997). If it did, the need for an independent analysis of an insured's bad faith claim would disappear, as the applicable section 8371 claim would turn specifically on the underlying coverage determination. The Pennsylvania courts, however, have construed section 8371 to provide a remedy for insureds whose claims are denied on unreasonable bases.²⁸

This approach was not new in Pennsylvania — it had been used since at least the early to mid-1990s. In 1994, in *Devich v. Commercial Union Insurance Co.*,²⁹ an insurer denied coverage based on a policy exclusion whose scope was yet undetermined by the appellate courts.³⁰ In that case, the district court ultimately determined that the insurer's reliance on the exclusion was misplaced and “imprudent,” but that the insurer's conduct still did not rise to the level of bad faith.³¹ The court held, “Although we have determined that this was a faulty basis for coverage denial, it was not unreasonable for [the insurance company] to rely on the exclusion in view of the status of the law in Pennsylvania with respect to the scope of the exclusion.”³² Thus, with regards to oftentimes complex coverage disputes, insurers have a right to be wrong and not be subjected to having to defend a claim of bad faith, as long as they act reasonably.³³ Courts have utilized an objective, retrospective bad faith analysis in looking at insurer conduct, holding that if some reasonable basis existed for an insurer's decision, even if the insurer did not rely on that reason, there cannot be bad faith.³⁴

Earlier Cases: Litigation Conduct “Safe Havens”

While outside the stated time frame of review of this article, i.e., 2007–2009, courts in Pennsylvania have long taken some degree of care to afford insur-

ers a degree of latitude in defending themselves in litigation without fear that the very defense they mount might itself form the basis of claims on the part of insureds that the insurer is guilty of bad faith conduct. This “litigation conduct” safe haven is well established.³⁵

In the Superior Court's 1999 ruling in *O'Donnell v. Allstate*,³⁶ the court held that the bad faith statute “clearly does not contemplate actions for bad faith based upon allegation of discovery violations; bad faith statute covers conduct of insurer as insurer, not as legal adversary.”³⁷ Similarly, in 1999, the court in *Slater v. Liberty Mutual Insurance*³⁸ took the same narrow approach that was to be taken in *Toy* some eight years later, predicting that the Pennsylvania Supreme Court would not permit § 8371 to provide a remedy for “discovery abuses by an insurer or its lawyer in defending a claim predicated on its alleged prior bad faith handling of an insurance claim.”³⁹

It has also been held that it is not evidence of bad faith if an insurer files a counterclaim in a bad faith case pursuant to federal rules of civil procedure.⁴⁰

Constitutional Issues — Punitive Damages

Because, under most bad faith statutory schemes, insurers are exposed to the quasi-criminal sanction of punitive damages, insurers may well consider raising constitutional protections as part of their arsenal of defenses, especially in response to allegations of corporate patterns and practices which, of necessity, involve nonparties to a given case. The United States Supreme Court has ruled that forcing a litigant exposed to punitive damages to defend against such faceless claims is a procedural due process violation.⁴¹

Forerunner: *State Farm v. Campbell* (2003)

In *State Farm Mutual Auto Insurance Company v. Campbell*,⁴² the United States Supreme Court addressed the constitutionality of punitive damages awards expressed in terms of a multiple of the compensatory damages award. In so doing, the court held that “few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.”⁴³ The court added that an award of more than four times the amount of compensatory damages might be closer to the line of “constitutional impropriety.” Finally, the court held

that where compensatory damages were substantial, a lesser ratio might even be appropriate.

Recently, the Third Circuit Court of Appeals, in *Jurinko v. Medical Protective Co.*,⁴⁴ issued an opinion strongly suggesting that the appropriate punitive damages ratio in the vast majority of cases is approximately 1:1, not 4:1, and not 9:1. In *Jurinko*, the Third Circuit affirmed a judgment against the insurer in a bad faith case, but in so doing, unanimously reduced a punitive damages award of \$6.25 million on a compensatory award of \$1.66 million to a number roughly approximating the 1:1 ratio.

While the *Jurinko* court left room for the possibility of larger ratios in cases of egregious behavior, its decision seems to signal a downward-moving trend of ratios, from 9:1, initially, to 4:1, and, now, potentially down as far as 1:1. There is room for exceptions, although in the overwhelming majority of cases, especially where large compensatory awards are made, *Jurinko* is valid support for an argument that any punitive damages award in excess of 1:1 may violate a defendant's due process rights. Because the Pennsylvania bad faith statute specifically allows the possibility of a punitive damages award,⁴⁵ *Jurinko* is important to insurers defending against those cases.

Burden of Proof: "Clear and Convincing Evidence" Standard

Because of the quasi-criminal nature of punitive damages that apply to statutory bad faith claims in Pennsylvania,⁴⁶ the "clear and convincing evidence" burden of proof stands as an important threshold protection for insurers as defendants in bad faith insurance cases. Pennsylvania courts have regularly and routinely affirmed that recovery of damages under Pennsylvania's bad faith statute requires a plaintiff to prove bad faith not merely by the civil "preponderance of the evidence" standard, but rather, by clear and convincing evidence. This standard has been articulated numerous times.⁴⁷

In discussing the clear and convincing standard, one court has observed the following:

Under Pennsylvania law, a claim that an insurer acted in bad faith must be proven by clear and convincing evidence. *Polselli v. Nationwide Mut. Fire Ins. Co.*, 23 F.3d 747, 750-51 (3d

Cir.1994) (citing *Cowden v. Aetna Casualty and Surety Co.*, 134 A.2d 223, 229 (Pa.1957). "[T]he clear and convincing evidence standard requires evidence that is "so clear, direct, weighty, and convincing as to enable the [fact-finder] to come to a clear conviction, without hesitancy, of the truth of the precise facts [in dispute]." *Commonwealth v. Maldonado*, 838 A.2d 710, 715 (Pa.2003), quoting *Rohm and Haas Co.*, 781 A.2d at 1179.⁴⁸

Inasmuch as this standard provides an important protection, it should be raised on an insurer's behalf at each opportunity in any bad faith proceeding.

Expanding the Analysis: Key Bad Faith Decisions in Other States

Courts across the country have, for the most part, followed the trend seen in Pennsylvania: to give insurers a wider behavioral space within which to process and decide claims. They have, in most instances, reinforced the premise that the insurer that makes claims decisions with a demonstrable, reasonable basis to do so does not act in bad faith and cannot be held liable under bad faith law, whether common law or statutory law. Not every state defines the standard in terms of "reasonable basis," but all states do focus on that or a similar concept to one degree or another, albeit under varying terminology.

South Dakota

In 2009, the Supreme Court of South Dakota ruled that for an insured to recover on a bad faith claim, she had to establish both (1) the absence of a reasonable basis for the denial of policy benefits or the failure to comply with a duty under the insurance contract *and* (2) the knowledge or reckless disregard of the lack of a reasonable basis for the denial.⁴⁹ The court did go on to hold that an insurer's knowledge of the lack of a reasonable basis may be inferred and imputed to an insurer where there was a reckless disregard of a lack of a reasonable basis.⁵⁰ It also ruled, however, that an insurer will escape bad faith liability when it challenges or denies underlying claims that are "fairly debatable."⁵¹ In bad faith parlance, "fairly debatable" is used almost as often as is "reasonable basis" by those whose businesses take them across state lines.

California

The general trend may have been to look at the bad faith cause of action as a narrow one in some states. In a California case that yielded an outcome with a narrow focus similar in scope to that in *Toy*, an appeals court ruled that violations by Geico Insurance of its own underwriting guidelines could not be used as the basis for a bad faith claim because those guidelines were not written into the insuring agreement between the insurer and the insured.⁵²

Delaware

Also in 2009, a federal district court in Delaware refused to declare that the insuring relationship creates a fiduciary obligation such that a bad faith claim might be more easily established. In *Frances Brousseau v. Kristin Laccetti, et al.*,⁵³ while in the process of ruling that an individual claims adjuster cannot be liable for bad faith denial of a long-term disability insurance claim, the presiding judge, relying on established state law, also ruled that an insurance policy did not create a fiduciary duty running from the insurer to the insured. The presiding judge granted the insurer's motion to dismiss, over the insured's argument that the policy was called an "Insurance Trust," noting, "Simply calling the relationship a 'trust' does not convert it to a trust."⁵⁴

Louisiana

Over the last several years, courts have shown increased willingness to look beyond the ease of a presumption of bad faith in cases involving, e.g., delay, and to put under scrutiny not only the circumstances of the specific insurance claim, but the conduct of the insured as well. For example, in *Chehardy v. Allstate Insurance Co.*,⁵⁵ the U.S. District Court for the Eastern District of Louisiana granted summary judgment for Allstate on the insured's bad faith claim under a homeowner's policy in a case arising from Hurricane Katrina, finding that Allstate waited three years for property damage records from the insured, and the insured was responsible, at least in part, for the delay in resolving the claim.⁵⁶

Specific Insurer Claims Practices

As in Pennsylvania, a number of court decisions across the states in the last several years have commented on specific insurer claims practices in such a

way as to endorse those claims practices when used properly in the correct contexts. For example, in Oklahoma, an appeals court has held that the mere act of surveillance of an insured who has made a personal injury insurance claim in itself does not rise to the level of bad faith.⁵⁷ In addition, the 10th Circuit Court of Appeals signaled a willingness to consider the insured's role in delaying a claim payment as part of its bad faith analysis. In *Wade v. EMASCO Insurance Company*,⁵⁸ the court examined the chronology of the insurance claim, noting that at certain points during the claim, the insured failed to provide medical records and at times made and at other times withdrew settlement demands, each action having an impact on the timeline of the claim.⁵⁹

In 2007, the Indiana Court of Appeals considered the insurer's right of claims investigation in *Austin v. Globe American Casualty Co.*⁶⁰ In this bad faith case, the court entered judgment in favor of the insurer following the insurer's delay in paying an automobile loss. The court held, as a matter of law, that the insurer was justified in postponing the payment while it investigated the circumstances of the automobile loss, a right that the insurer specifically reserved to itself under the automobile policy.⁶¹ In 2008, the 10th United States Circuit Court of Appeals ruled that especially where there was conflict in the medical records in a UM/UIM matter, an insurer was entitled to investigate causation before making a decision on a claim without committing bad faith.⁶²

Recent decisions seem to support the insurer's right to avail itself of investigative rights reserved to itself in the insuring agreement, such as the right to conduct independent medical examinations of their insureds. For example, recently, the 9th Circuit Court United States Court of Appeals held that in a case where there was conflicting medical opinion as to the reasonableness of the need for spinal surgery, it was not bad faith for an insurer to request an independent medical exam, specifically provided for in an automobile insurance policy where an insured sought PIP benefits.⁶³

Insurers can often find themselves in a catch-22 situation with respect to the timeliness in which they turn around a decision on a claim. If they return a decision too quickly and the claim is denied, they expose themselves to the charge that it is a knee-jerk denial. If insurers take too long, they are charged with bad faith delay. The 11th U.S. Circuit Court of Appeals addressed the former contingency,

dismissing the claim that a prompt decision is in and of itself bad faith.⁶⁴

With respect to the converse situation, one Pennsylvania court has ruled that agreeing to reconsider an insured's claim is not evidence of bad faith.⁶⁵ These interpretations, it would seem, are consistent with public policies that encourage insurers to (a) decide claims promptly where possible, but also to (b) keep open minds on claims and (c) consider additional evidence concerning a claim as such evidence may come available.

Litigation Conduct Cases

As in Pennsylvania, courts in other states have been careful to carve out room for insurers to operate to defend themselves in insurance litigation without worrying that they would create additional bad faith exposure for themselves. An appeals court in Washington has recently held that an insurer can assert defenses in an UM/UIM proceeding, as such proceedings are "adversarial."⁶⁶ An Oklahoma court has held that an insurer's conduct, through counsel, in discovery, is conduct as a litigant, not an insurer and, therefore, not actionable bad faith.⁶⁷ Earlier this year, a federal district court in Paducah, Kentucky, held that an insurer's conduct in defending against and opposing a UIM claim could not be considered evidence of bad faith and was protected "litigation conduct."⁶⁸ The district court relied on earlier precedent from the Supreme Court of Kentucky to legitimize the insurer's right to defend against the claim.⁶⁹

The protection articulated in this line of cases arises from the rather commonsense premise that an insurer, no less than any other litigant, is entitled to an aggressive defense.⁷⁰ One writer has advanced the argument that litigation conduct should not be considered evidence of bad faith because it is not contemplated by the parties at the time the insurance contract is formed and it would have a chilling affect on legitimate advocacy.⁷¹ The author believes the latter argument is more persuasive than the former and is alone a sufficient reason to protect litigation conduct from bad faith liability.

Constitutional Issues — Procedural Due Process

The United States Supreme Court has ruled that

a defendant that is exposed to the possibility of a punitive damages award against it is entitled to the procedural due process rights of presenting "every available defense."

Foundation: *Williams v. Phillip Morris* (U.S. 2007)

In *Williams v. Phillip Morris*,⁷² the U.S. Supreme Court overturned a large punitive damages award, after taking up the issue of whether punitive damages could be imposed against a defendant in a civil case on the basis of evidence introduced in the case regarding harm to nonparties. The court held that the introduction of such evidence was not constitutionally appropriate, as it imposed upon the defendant the burden of defending against a multitude of claims for which it was not prepared.⁷³ In overturning the punitive damages award, however, the court discussed the basic principle that because punitive damages went beyond compensation and reached punishment, procedural due process protections were required.⁷⁴ It further held that the right of procedural due process afforded to a defendant facing punitive damages the right to present "every available defense."⁷⁵

Williams was relied upon in 2007 by the Federal 9th Circuit Court of Appeals in the insurance litigation context in *Merrick v. Paul Revere Ins. Co.*⁷⁶ The court granted a new trial in favor of Paul Revere on the issue of punitive damages, relying on *Williams* and the due process protections afforded:

The Due Process Clause 'forbids a State to use a punitive damages award to punish a defendant for injury that it inflicts upon nonparties.' *Philip Morris USA v. Williams*, ___ U.S. ___, 127 S.Ct. 1057, 1063, 166 L.Ed.2d 940 (2007). As the Supreme Court has recently explained, such punishment runs afoul of the maxim that a state must afford a defendant an opportunity to present every available defense. *Id.* (citing *Lindsey v. Normet*, 405 U.S. 56, 66, 92 S.Ct. 862, 31 L.Ed.2d 36 (1972)). A defendant 'threatened with punishment for injuring a nonparty victim' may be unable to present defenses applicable to the nonparty victim, if those defenses do not also coincide with those relevant to the plaintiff's claim. *Id.* In addition, punishment for nonparty injury adds 'a near standardless dimension to the punitive

damages equation,' as jury speculation regarding the number of nonparties injured and the extent of their injuries magnifies traditional due process concerns regarding the arbitrariness, uncertainty, and lack of notice afflicting a punitive award.

Williams clarified that a plaintiff may offer evidence of 'harm to other victims' to show the reprehensibility of a defendant's conduct in this case. *Id.* at 1063–64. 'Evidence of actual harm to nonparties can help to show that the conduct that harmed the plaintiff also posed a substantial risk of harm to the general public, and so was particularly reprehensible.' *Williams*, 127 S. Ct at 1064. But 'a jury may not go further than this and use a punitive damages verdict to punish a defendant directly on account of harms it is alleged to have visited on nonparties.' *Id.* (emphasis added). Where there is a 'significant' risk that the jury might do so — a risk generated, for example, by 'the sort of evidence that was introduced at trial or the kinds of argument the plaintiff made to the jury' — a court, upon request, must 'provide some form of protection' to assure that juries 'are not asking the wrong question.'⁷⁷

The court continued, "We therefore conclude that the district court erred in failing to instruct the jury that it could not punish the defendants for conduct that harmed only nonparties."⁷⁸

Similarly, a federal trial court in Hawaii questioned the relevance of an insurer's allegedly unlawful conduct outside of Hawaii to the inquiry of whether that insurer violated Hawaiian insurance claims statutes.⁷⁹ Trial courts have also openly questioned whether the fundamental fairness problem posed by allowing consideration of injuries to nonparties might also require stricter discipline in the area of discovery such that plaintiffs should not be allowed access to such a broad array of claims files involving those nonparties.⁸⁰

Inasmuch as punitive damages are part and parcel of many insurance statutory and common law bad faith schemes and, in almost all instances, the value that attracts interest in and that drives the cases, one perhaps can think of no clearer constitutional protection so closely related to insurance bad faith than the

issue of "pattern of conduct" claims and evidence involving nonparties. Going forward, then, the constitutional protections provided by procedural due process cases and punitive damages multiple cases could be instrumental to insurers in defending themselves in insurance bad faith litigation.

Reading the Tea Leaves: Predictive Bad Faith Analysis, 2010–2012

It is said that the law is a jealous mistress. She is also a mistress not without her moods: If one waits on her long enough, her disposition will turn. It is not, therefore, beyond the realm of the possible to think that toward mid-to-late 2012, bad faith case law might make a slight course correction and revert moderately back toward center. This movement may include some reexpansion of the application of bad faith statutes in certain areas, thus restricting certain claims practices or claims department discretion that had previously been loosened. Such are the vicissitudes of any nonstatic system. Insurers and insureds both participate in such a system.

The interplay between state unfair trade and insurance practice laws and state insurance bad faith statutes has historically been a nettlesome one for the courts, on both state and federal levels. To the extent state or federal court decisions retrace some of their steps over the last 3–5 years in the next 3–5, insurer claim departments may see some loss of discretion and control due to case decisions in those areas. More specifically, courts might increasingly impose bad faith liability for an insurer's failure to comply with either state trade practice and consumer protection requirements or claim practice requirements, whereas, in the past, such departures may not have been actionable.⁸¹

To the extent that predictions can be made regarding where insurers can hold or, perhaps, even gain ground in insurance bad faith litigation, it appears that on a macro level, the decisions regarding issues of punitive damages and constitutional due process protections might continue to be decided in favor of protecting insurers' rights. It would not appear to be wholly unreasonable to forecast that opinions reducing or limiting punitive damage awards, including punitive damage awards in insurance bad faith cases, will continue.⁸²

Reverse Bad Faith

A fertile and unexplored area for development in bad faith law over the next 5 years, perhaps even 10 or 15 years, is the Doctrine of Reverse Bad Faith, i.e., the imposition of direct civil liability on the insured to the insurer for the insured's bad faith conduct in the making of an insurance claim. Nearly 15 years ago, in an article in the *Seton Hall Law Review*, Douglas Richmond sounded the alarm:

Plaintiffs' attorneys today strive to manipulate insurers into extracontractual and punitive exposure. Increasingly, plaintiffs groundlessly allege insurance companies' bad faith in attempts to win the judicial lottery. As explained by Judge Kozinski of the Ninth Circuit ... 'This tortification of contract law — the tendency of contract disputes to metastasize into torts — gives rise to a new form of entrepreneurship: investment in tort causes of action.' ***There now exists a nightmarish extracontractual insurance culture.***⁸³

So, too, in 1995, the United States District Court for the Eastern District of Pennsylvania predicted:

The absence of a statutory right of an insurer to punitive damages does not preclude an insurer's claim against an insured for breach of a contractual obligation of good faith with the right to recover whatever common law damages, if any, it might have suffered. This court concludes that Pennsylvania would apply the duty to act in good faith to 'each party' to an insurance contract, including the insured. Such a holding is in conformity with the language of *Section 205 of the Restatement (2d) of Contracts* and not inconsistent with Pennsylvania precedents.⁸⁴

To one degree or another, the doctrine has been recognized in Pennsylvania and in other states.⁸⁵ Its proper place, whether it be recognized as a complete defense, an apportionment device, or simply a concept, has been left largely underconsidered. At a minimum, the use of reverse bad faith as a means of organic, internal regulation of misuse of bad faith claims should be considered, in the opinion of the author.

In terms of what has actually transpired with the doctrine thus far, in 2006, the United States District Court for the Middle District of Pennsylvania allowed reverse bad faith to be pled as an affirmative defense and, in turn, prevented the insured from using the allegation as the basis for alleging additional bad faith against the insurer.⁸⁶ The conduct of the insured does not altogether escape scrutiny in other states. However, with limited exception, the Doctrine of Reverse Bad Faith has not been rigorously developed or endorsed. There are other rules and guidelines that regulate a litigant's pleadings well apart from state bad faith laws.⁸⁷ Thus far, most courts have been comfortable with allowing the quality of an insurer's pleading to be regulated by those rules and not by bad faith law.

Discovery

Discovery is almost always hotly contested and hard-fought territory in a bad faith case, and this is compounded by the fact that the attorney-client privilege is currently under close scrutiny by the Pennsylvania Supreme Court. In *Nationwide Mutual Insurance Company v. Fleming*,⁸⁸ the Supreme Court is considering the lower Superior Court ruling that attorney-client privilege did not apply to a confidential memorandum written by an insurer's in-house legal staff to the insurer's senior executives. While, strictly speaking, the attorney-client privilege is not "a defense" to a bad faith claim, it is a large and important defense against attempts to invade this right during discovery. This battle is likely to be fought in bad faith cases and in courts across the country in the next 3–5 years. The outcomes of these battles will have a tremendous impact on how insurers defend themselves in bad faith cases during, and following, that time.

Conclusion

Insurers have always had discretion in processing and deciding the insurance claims submitted to them by their insureds. Though their right of discretion may never have been taken from them completely, the arrival of modern state insurance bad faith statutes, common law decisions, and regulatory schemes has, in certain circumstances, impaired and, in some areas of claims adjusting, substantially impaired, insurers' rights

not only to investigate and decide insurance claims, but to protect their rights in litigating those claims.

Judicial decisions in the Commonwealth of Pennsylvania between 2007 and 2009 serve as particularly instructive examples of a trend in the courts to reconfer to insurers a greater measure of discretion and latitude in the claims process by holding in check the expansion of insurance bad faith, statutory, regulatory, and common law schemes. In decisions that address both procedural considerations and specific substantive claims practices, insurers have received, over the last three years, some additional room in which to operate their claims departments. This general trend can be seen in additional states across the country.

It is difficult to predict the future direction of insurance bad faith law. To the extent that the trend of granting insurers more discretion abates, we may see a retracement in favor of insureds in the areas of unfair trade practice and consumer protection law decisions, in which such statutes are used in conjunction with insurance bad faith statutes to restrict insurer discretion in claims operations. Insurers, however, are likely to hold gains and, perhaps, make further gains in the areas of punitive damage limitations and constitutional protections preventing the introduction of evidence regarding harm to nonparties into bad faith cases. Regardless of what the future holds in store, it is sure to hold the attention of both insureds and insurers alike.

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Endnotes

1. See, e.g., Richmond, Douglas, "An Overview of Insurance Bad Faith Law and Litigation," *Seton Hall Law Review* 25 (1994): 74, 89, 109.
2. *Toy v. Metropolitan Life Ins. Co.*, 593 Pa. 20, 928 A.2d 186 (Pa. July 18, 2007) (Cappy, J.).
3. *Ibid.*
4. *Ash v. Continental Ins. Co.*, 932 A.2d 877, 2007 WL 2962716 (Pa. 2007).
5. Pennsylvania's bad faith statute reads as follows:
Purdon's Pennsylvania Statutes and Consolidated Statutes (last updated May 21, 2009)
Title 42 Pa.C.S.A. Judiciary and Judicial Procedure
Part VII. Civil Actions and Proceedings
Chapter 83. Particular Rights and Immunities
Subchapter G. Special Damages
§ 8371. Actions on insurance policies
In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:
(1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
(2) Award punitive damages against the insurer.
(3) Assess court costs and attorney fees against the insurer.
6. *Ash*, 932 A.2d at 531.
7. *Ibid.*
8. See *Condio v. Erie Ins. Exch.*, 899 A.2d 1136, 1142 (Pa. Super. 2006), 593 Pa. 20, 928 A.2d 186; see also, *Zappile v. Amex Assurance*, 2007 WL 1651271 (Pa. Super. 2007)
9. *Toy*, *ibid.* Whether insurers will continue to enjoy the benefit of such gains is a separate question: The makeup of the Court has changed since 2007 through election turnover. For discussion on a macro level of what trends might be seen in insurance bad faith law going forward, see the brief predictive analysis included in Section IV.
10. The reach of potential defendants under § 8371 has been limited as well. For example, outside insurance adjusters have been held not to be proper defendants under the bad faith statute. See *Stephano v. Tri-Arc Financial Services, Inc.*, 2008 WL 625011 (Pa. M.D., March 4, 2008); see also, *Frances Brousseau v. Kristin Laccetti, et al.*, 2009 U.S. Dist. LEXIS 106681 (Del. 2009) (individual claims adjuster cannot be liable for bad faith denial of long-term disability insurance claim; neither individual adjuster nor insurer can be liable under Delaware law for breach of fiduciary duty claim; insuring agreement is an "arm's length" transaction.)
11. *Zappile v. Amex Assurance*, 928 A.2d 251 (Pa. Super. 2007).
12. *Condio v. Erie Ins. Exch.*, *id.*
13. *Zappile*, *Id.*
14. *Ibid.*
15. *Ibid.*
16. *Ibid.* at n. 7.
17. See also, *Victoria Insurance Company v. Ren*, 2008 WL 2371850 (E.D.Pa., June 9, 2008) (claims that insurer committed bad faith by filing a declaratory judgment action and asserted defenses including policy exclusions dismissed as a

- matter of law).
18. See *Ridgeway v. U.S. Life Credit Life Insurance Company*, Pa. Super., 793 A.2d 972 (Pa. Super. 2002). See also, *O'Donnell v. Allstate Insurance Company*, 734 A.2d 901, 908-909 (Pa. Super. 1999) (the bad faith statute “clearly does not contemplate actions for bad faith based upon allegation of discovery violations; bad faith statute covers conduct of insurer as insurer, not as legal adversary); *Slater v. Liberty Mutual Insurance*, 1999 U.S. Dist. Lexis 3753 (E.D. Pa. 1999) (“The court believes that the Pennsylvania Supreme Court would not hold that § 8371 permits a recovery for discovery abuses by an insurer or its lawyer in defending a claim predicated on its alleged prior bad faith handling of an insurance claim.” Court states that insurer’s bad faith counsel are not agents of insurer for purposes of bad faith conduct.) See also, *Javorski v. Nationwide*, U.S. Dist. Ct., M.D., PA, 3:06-cv-01071-RPC (slip op. November 30, 2006); *Hollock v. Erie Ins. Exchange*, 903 A.2d 1185, 1188 (Pa. 2006) (Cappy, C.J., dissent); *Accord, Knotts v. Zurich Insurance*, 197 S.W.3d 512 (2006) (“an insurer — like every other litigant — is entitled to an aggressive defense; allowing bad faith claims premised upon such conduct ‘threatens to turn our adversarial system on its head.’”); *Oehlmann v. Met Life Ins. Co.*, 644 F.Supp.2d 521 (2007).
 19. *Zappile v. Amex Assurance*, 928 A.2d 251 (Pa. Super. 2007).
 20. See *Wedemeyer v. The United States Life Insurance Company in the City of New York, et al.*, 2007 WL 710290 (E.D. Pa. March 6, 2007).
 21. *Allison v. Allstate Indemnity Co.*, 2008 WL 2631557 (E.D.Pa., slip op., June 27, 2008).
 22. *Ibid.*, citing *Smith v. Westfield Insurance Company*, 2007 WL 1740816, p. 4, (Pa.E.D., June 15, 2007).
 23. *Employees Mutual v. Loos*, 476 F. Supp.2d 478 (W.D.Pa., February 28, 2007).
 24. *Ibid.*, p. 13.
 25. *Pittas v. Hartford Life Insurance Company*, 513 F.Supp. 2d 493 (W.D.Pa. March 17, 2007); see also, *Oehlmann v. Met Life Insurance Company*, *id.*; *Moss Signs v. State Auto Insurance Company*, 2008 WL 892032 (Slip Opinion W.D. Pa. April 2, 2008).
 26. *Stacey Smith, et al. v. Continental Casualty Co.*, No. 08-4140, 3rd Cir.; 2009 U.S. App. LEXIS 22240.
 27. *Employers Mutual v. Loos*, *id.* at p. 12, 16 (also holding that aggressive defense of questionable UI claim is not bad faith).
 28. *Ibid.*
 29. *Devich v. Commercial Union Insurance Co.*, 867 F.Supp. 1230 (W.D.Pa. 1994).
 30. See, generally, *ibid.*
 31. *Ibid.*
 32. *Ibid.*
 33. *Ibid.*
 34. *Wedemeyer v. The United States Life Insurance Company in the City of New York, et al.*, *id.* For earlier decisions on this standard, see, e.g., *Livornese v. Med. Protective Co.*, 219 F.Supp.2d 645, 648 (E.D.Pa.2002), rev’d on other grounds, 136 Fed. Appx. 473 (3rd Cir. June 9, 2005); *Williams v. Hartford Cas. Ins. Co.*, 83 F.Supp.2d 567, 574 (E.D.Pa.2000), aff’d, 261 F.3d 495 (3rd Cir.2001).
 35. See *O'Donnell v. Allstate*, 734 A.2d 901, 908-909 (Pa. Super. 1999); *Slater v. Liberty Mutual Insurance*, 1999 U.S. Dist. Lexis 3753 (E.D. Pa. 1999).
 36. *O'Donnell v. Allstate*, *ibid.*
 37. *Ibid.*
 38. *Slater v. Liberty Mutual Insurance*, *id.*
 39. *Ibid.* “The conduct of an insurer’s counsel in litigation including the propounding of discovery as a general rule does not constitute bad faith under section 8371.” McMonigle, Richard Jr., Ed., *Insurance Bad Faith In Pennsylvania*, 7th ed., section 1.05, p. 8 (Philadelphia: ALM Publishing, Inc.).
 40. *Leach v. Northwest Mutual Ins.*, 2005 U.S. Dist. LEXIS 39966, aff’d 2008 Fed. Appx 455, (3d Cir. 2008).
 41. *Phillip Morris USA v. Williams*, 127 S. Ct. 1057, 1063 (“the Due Process Clause prohibits a State from punishing an individual without first providing that individual with an opportunity to present every available defense.”) For further discussion on the role of constitutional protections of insurers in due process litigation, see Haddick, C.J., “Do Insurers Have Constitutional Rights? Due Process in Bad Faith Claims,” *Claims Magazine* (May 5, 2009).
 42. *State Farm Mutual Automobile Insurance Co. v. Campbell et al.*, 538 U.S. 408 (2003).
 43. *Ibid.*, 425.
 44. *Jurinko v. Medical Protective Co.*, 2008 WL 5378011 (3d Cir., December 24, 2008).
 45. See 42 Pa. C.S.A. § 8371.
 46. *Ibid.*
 47. *Kubrick v. Allstate Ins. Co.*, 2004 U.S. Dist. LEXIS 358 (E.D. January 7, 2004). See also *Wedemeyer v. The United States Life Insurance Company in the City of New York, et al.*, *id.*; *Smith v. Westfield Ins. Co.*, 2007 WL 1740816 (E.D.Pa., June 15, 2007); *Kidd v. Prudential Ins. Co. of America*, Slip Copy, 2008 WL 163055 (M.D.Pa., Jan. 15, 2008); *Blaylock v. Allstate Insurance Company*, Slip Copy, 2008 WL 80056 (M.D.Pa Jan. 7, 2008).
 48. *Wezorek v. Allstate Ins. Co.*, Slip Copy, 2007 WL 2264096 (E.D.Pa., August 7, 2007), p. 13.
 49. *Dakota Minnesota and Eastern Railroad Corp. v. Acuity*, 771 N.W.2d 623, 49 (SD August 5, 2009).
 50. *Ibid.*
 51. *Ibid.* This is consistent with the law of Pennsylvania. “An

- insurance company's review of the claim file need not conform to a perfect standard in order to avoid liability for bad faith." *Santer v. Teachers Insurance and Annuity Assoc.*, 2008 WL 755774 (Ed.Pa. March 18, 2008) (Golden, J.).
52. *Kevorkov v. Direct*, 2009 Cal. App. Unpub. LEXIS 1824 (Cal. App. 2d Dist. Mar. 6, 2009).
 53. *Frances Brousseau v. Kristin Laccetti, et al.*, 2009 U.S. Dist. LEXIS 106681 (Del. 2009).
 54. *Ibid.*
 55. *Chehardy v. Allstate Insurance Co.*, 2009 WL 3320409 (E.D. La. Oct. 14, 2009).
 56. *Ibid.*
 57. *Johnson v. Liberty Life Assurance Co. of Boston*, Slip WL 268290 (C.A. 10 Ok. 2008).
 58. *Wade v. EMASCO Insurance Company*, 453 F.3d. 657 (10th Cir. 2007).
 59. *Ibid.*
 60. *Austin v. Globe American Casualty Co.*, 39805-0606-CV-343.
 61. *Id.*
 62. *Billie Sellman as personal representative of Betty L. Sico v. AMEX Assurance Co., aka IDS Property Casualty Insurance Co.*, Slip Opinion 10th Cir. Court of Appeals, No. 08-5089, 2008 U.S. App. LEXIS 8253.
 63. *Tara D. Sadler, et al. v. State Farm Mutual*, 2009 U.S. App. Lexis 24316 (9th Cir. 2009).
 64. *Johnson v. Geico Gen. Ins. Co.*, 318 Fed. Appx. 847, 2009 U.S. App. LEXIS 5121 (11th Cir. Fla. 2009).
 65. *CRS Auto Parts v. Nat'l Grange*, 2009 WL 249776 (E.D. Pa. 2009).
 66. *Cheryl P. Greene, et al., appellants, v. Ralph Alexander Young, et al., defendants, Allstate Ins. Co., respondent*, 2008 Wash. App. LEXIS 1636.
 67. *Johnson v. Government Employees Ins. Co.*, Slip Copy, 2008 WL 2323241 (W.D.Okla. 2008) (no discovery on litigation conduct permitted, only discovery regarding insurer conduct as insurer).
 68. *Virginia Budde v. State Farm Mutual*, 2009 U.S. Dist. LEXIS 98567 (W.D. Ken. 2009).
 69. *Knotts v. Zurich Insurance*, 197 S.W.3d 512 (2006).
 70. *See, e.g., Knotts v. Zurich Insurance*, *ibid.* ("an insurer — like every other litigant — is entitled to an aggressive defense; allowing bad faith claims premised upon such conduct 'threatens to turn our adversarial system on its head.'").
 71. Caudle, Sheila R., and Jonathan Cohen, "Litigation Conduct: Removing the 'Bad Faith' Trap," *Insurance Coverage Law Bulletin* 6, no. 2 (March 2007): 1.
 72. *Philip Morris USA v. Williams*, 549 U.S. ___, 127 S.Ct. 1057, 1063, 166 L.Ed.2d 940 (2007).
 73. *Ibid.* at 1065.
 74. *Ibid.* at 1063.
 75. *Ibid.*
 76. *Merrick v. Paul Revere Life Ins. Co.*, 500 F.3d 1007, 1016 (9th Cir., 2007).
 77. *Ibid.*
 78. *Ibid.* at 1017.
 79. *Mauna Kea Beach Hotel Corp. and Hapuna Beach Prince Hotel Corp. v. Affiliated FM Insurance Co.*, No. 07-00605 DAE-KSC, D. Hawaii; 2009 U.S. Dist. LEXIS 38078.
 80. *See, e.g., Deborah Sieveking v. Reliastar Life Insurance Co. and Madison National Life Insurance Co.*, No. 4:08-cv-45-DFH-WGH, S.D. Ind., New Albany Div.; 2009 U.S. Dist. LEXIS 33466.
 81. *See Toy*, note 2, *id.*
 82. *See, e.g., Jurinko v. Medical Protective Company*, *id.* (Court endorses a 1:1 punitive damages to compensatory damages ratio in insurance bad faith case).
 83. Richmond, Douglas, *id.* (emphasis added). *See also* Little, Cathryn, M. "Fighting Fire with Fire — Reverse Bad Faith and First Party Litigation Involving Arson and Insurance Fraud," *Campbell Law Review* 19 (Fall 1996): 43, 48, 49.
 84. *Greater New York Mutual Insurance Co. v. North River Ins. Co.*, 872 F. Supp 1403, 1407–1408, as cited in *Garvey v. National Grange Mutual Insurance Company*, 1995 WL 461228 (E.D.Pa. 1995) at p. 2.
 85. *See, e.g., Javorski v. Nationwide Insurance*, Civil Action No. 3:06-CV-1071 (M.D. Pa. November 30, 2006) (Conaboy, J.) (specifically authorizing a reverse bad faith claim against an insured and, in turn, denying the insured's request to amend the complaint to assert post-litigation conduct of the insurer as additional grounds for bad faith claim).
 86. *Ibid.*
 87. *See, e.g., FR.C.P. 11 and Pa.R.C.P. 1023.1.*
 88. *Nationwide Mutual Insurance Company v. Fleming*, 594 Pa. 311, 935 A.2d 1270, 2007 Pa. LEXIS 2361 (2007).

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