Play Your Best Hand

# Bad Faith in Absence of Breach of Contract?

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**Does your jurisdiction follow the majority (breach required) or minority (breach not required) position?**

Plaintiffs in insurance coverage actions often bring claims for bad faith in order to attempt to ratchet up the potential damages that can be recovered. In appropriate circumstances, defendants can challenge the claim with a motion to dismiss based on the inadequacy of the pleading (especially in federal court). However, defendants are well advised to determine if another arrow is in their quiver. In many jurisdictions, bad faith claims cannot survive where there is no underlying breach of contract. Not all jurisdictions follow this approach, however. Knowing the law of the jurisdiction applicable to your case may lead you to make a well-timed motion that will eliminate the bad faith claim and change the underlying math of the plaintiff's damages case. This article explores the law of various jurisdictions concerning the right to bring bad faith claims in the absence of a breach of contract and aims to provide the lawyer faced with defending such a claim with some practical advice.

## Majority Position

The majority of jurisdictions hold that claims for bad faith are precluded if there is no breach of contract underlying the claim. *See, e.g.*, *Hudson Universal, Ltd. v. Aetna Ins. Co.*, 987 F. Supp. 337, 342 (D.N.J. 1997) (citing *Pickett v. Lloyd's*, 131 N.J. 457, 621 A.2d 445 (1993), for the proposition that an insurer's disclaimer of coverage cannot be held to be in bad faith unless the insured is granted summary judgment on the issue of coverage, and citing *O'Malley v. United States Fidelity & Guaranty Co.*, 776 F.2d 494 (5th Cir. 1985), for the idea that bad faith requires a determination that coverage exists under the policy for the loss claimed); *Green Machine Corp. v. Zurich American Ins. Group*, 2001 WL 1003217, *7 (E.D. Pa. 2001) (holding that a bad faith claim cannot survive summary judgment when the court makes a determination of no coverage); *American Nat'l Red Cross v. Travelers Indemnity Co. of Rhode Island*, 896 F. Supp. 8, 11 (D.D.C. 1995) ("An insured's claim of bad faith breach of contract against its insurer fails

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if coverage for the underlying claim does not exist."); Richmond, *Bad Insurance Bad Faith Law*, 39 Tort Trial & Ins. Prac. L.J. 1, 7–8 (2003). The following are more in-depth summaries of illustrative cases following the majority view.

In *Hudson Universal, Ltd. v. Aetna Ins. Co.*, 987 F. Supp. 337 (D.N.J. 1997), Aetna insured Hudson under an insurance policy that covered various risks, including advertising injuries. Following a dispute between Hudson and Bausch & Lomb over patent and trademark infringement and related issues, Hudson settled Bausch & Lomb's claims and subsequently demanded payment from its insurer under the advertising injury clause contained in the policy. Aetna denied coverage. The federal court, sitting in diversity, found that the highest court of New Jersey would follow the "fairly debatable" standard in making its determination of whether there was bad faith on the part of the insurer. Under this test, a claimant who could not have established as a matter of law a right to summary judgment on the substantive contract claim would not be entitled to assert a claim for the insurer's bad faith in refusing to pay. The court found this to be the rule expressed in *Pickett v. Lloyd's*, 131 N.J. 457, 621 A.2d 445 (1993). Thus, under the *Pickett* rule, unless an insured could establish coverage for its claim as a matter of law, no bad faith recovery cause of action could be maintained. Taking all factors into consideration, because the issue of whether or not Hudson's claims were covered under the Aetna policy was "fairly debatable," Aetna was entitled to summary judgment on Hudson's bad faith claims.

In *Anderson v. Georgia Farm Bureau Mut. Ins. Co.*, 225 Ga. App. 374, 566 S.E.2d 342 (2002), a property insurance policyholder sued to recover living expenses and the value of personal property damaged and destroyed when the insured's building burned down. However, no personal property was covered under the policy and the policy did not provide coverage for living expenses. The Court of Appeals affirmed the trial court's grant of summary judgment in favor of the defendant insurer on these claims. Additionally, the court found that "penalties for bad faith are not available where, as here, the insurance contract does not provide the coverage demanded." (citing *Collins v. Life Ins. Co. of Ga.*, 228 Ga. App. 301, 491 S.E.2d 517 (1997)). The court affirmed the trial court's grant of summary judgment on the bad faith claims as well.

*Green Machine Corp. v. Zurich American Ins. Group*, 2001 WL 1003217 (E.D. Pa. Aug. 24, 2001), *affirmed*, 313 F.3d 837 (3d Cir. 2002), involved a commercial general liability policy and claims made against it for patent infringement and related claims. Like in *Hudson*, Zurich denied coverage for the claims as outside the definition of "advertising injury" contemplated by the policy language. The court determined that no coverage existed for the infringement claims and granted summary judgment in favor of Zurich. Likewise, the court granted summary judgment on the bad faith claims, finding "Because this Court has determined that there was no coverage, a bad faith claim cannot survive summary judgment." *Green Machine* at *7. As stated by the court, under Pennsylvania law "bad faith claims cannot survive a determination that there was no duty to defend, because the court's determination that there was no potential coverage means that the insurer had good cause to refuse to defend." *Id.* citing *Frog Switch & Mfr. Co. v. Travelers Ins. Co.*, 193 F.3d 742, 751 n. 9 (3d Cir. 1999).

## Minority Position

In contrast to the above rulings, courts in a minority of states conclude that a breach of contract is not required for a plaintiff to maintain a bad faith action against an insurer. *See*, *e.g.*, *Matlack v. Mountain West Farm Bureau Mut. Ins. Co.*, 44 P.3d 73, 81 (Wyo. 2002) (finding that an insured need not prevail on the contract claim to pursue the bad faith claim); *Richardson v. Guardian Life Ins. Co. of America*, 161 Or. App. 615, 624, 984 P.2d 917, 923 (1999) (finding that it is possible for an insurer to breach the duty of good faith without breaching the insurance contract, but nevertheless finding that the trial court did not err in dismissing the plaintiff's claim for a breach of the duty of good faith and fair dealing when the plaintiff relied on "the same facts that he alleges constituted a breach of the insurance contract" in its tort claim); *Best Place, Inc. v. Penn America Ins. Co.*, 82 Haw. 120, 131, 920 P.2d 334, 345 (1996) (holding that the bad faith tort "allows an insured to recover even if the insurer performs the express covenant to pay claims" and explaining that an insurer can be liable for bad faith when it would not be liable for a tortious breach of contract); *Richmond*, *supra*.

Appleman speaks to the issue as follows: "Consequently, a bad faith action has been held maintainable against an insurer that has not breached its contract with the insured." 16A-310B Appleman on Insurance Law & Practice, Supp. to §8878.25. For this proposition, Appleman cites a North Carolina case *Robinson v. North Carolina Farm Bur. Ins. Co.*, 86 N.C. App. 44, 356 S.E.2d 392 (1987).

**Unless an insured** could establish coverage for its claim as a matter of law, no bad faith recovery cause of action could be maintained.

*Robinson* involved a restaurant that suffered significant damage due to a fire. The restaurant building and the building's contents were both insured under a multi-peril policy issued by North Carolina Farm Bureau Insurance Company. Farm Bureau paid the full policy limits of the claim for contents, but offered only partial payment of the coverage amount on the building. The evidence presented by the insured was that the insurer viewed the building as a total loss, delayed payment because the insured hired a property loss consultant, and then the insurer instructed its building contractor to produce a low estimate for repairs. The insurer eventually paid the total loss on the claim. The trial court granted summary judgment for the insurer on the bad faith claim. On appeal, the North Carolina Court of Appeals cited *Dailey v. Integon Ins. Co.*, 75 N.C. App. 387, 331 S.E.2d 148, *disc. rev. denied*, 314 N.C. 664, 336 S.E.2d 399 (1985), for the proposition that the torts that give rise to potential punitive damages are separate from the breach of contract claims arising out of the

insurance contract. The court of appeals in *Robinson* stated:

> We find nothing in the case law which *requires* that the tortious conduct be accompanied by a breach of the contract, even though most, if not all, of the cases have as a factual background the insurance company's refusal to pay. We do not believe an action for punitive damages from tortious conduct is precluded when the company eventually pays, if bad faith delay and aggravating conduct is present.

*Robinson* at 49–50, 356 S.E. 2d at 395 (emphasis in original). The appellate court reversed the grant of summary judgment for the insurer and allowed the bad faith claim to go to trial based on genuine issues of material fact. Thus, in North Carolina a breach of contract does not appear to be a prerequisite for recovery under a tort theory, at least where there is a covered claim. The following are more in-depth summaries of illustrative cases following the minority position.

**"Something more"** such as wanton or malicious conduct is required for an award of punitive damages.

In *Matlack v. Mountain West Farm Bureau Mut. Ins. Co.*, 44 P.3d 73 (Wyo. 2002), Matlack sold one of two tracts of land she owned to Moore. A dispute arose as to ownership of a water well located on the boundary between the two tracts of land. Over Matlack's objections, Moore started up a backhoe, dug around the well casing, and pulled it toward her property. When Matlack sued, Moore turned the matter over to her insurance carrier, Mountain West. Mountain West denied her claim because of the alleged acts were intentional and not subject to coverage under the policy. Matlack and Moore reached a settlement of claims and agreed that any recovery would solely be satisfied by recovery against an insurer. Mountain West filed a declaratory judgment action against Matlack, seeking a determination that the policy did not provide coverage for the losses, and Matlack counterclaimed for breach of contract and insurance bad faith. The trial court granted summary judgment for Mountain West on all claims, including bad faith, and the Wyoming Supreme Court affirmed. As in *Hudson*, the court applied a "fairly debatable" standard. The court cited *State Farm Mutual Automobile Ins. Co. v. Shrader*, 882 P.2d 813 (Wyo. 1994), for the following proposition: "While an insured may state claims for breach of contract and breach of the duty of good faith and fair dealing, the insured does not need to prevail on the contract claim to pursue the bad faith claim." *Matlack* at 81. However, the court nevertheless found that the "limited and transparent nature" of the facts alleged, including some alleged delays in responding to the amended complaint, did not present a genuine issue as to any material fact and affirmed the trial court's granting of summary judgment in favor of the insurer on the bad faith claims.

In *Richardson v. Guardian Life Ins. Co.*, 161 Or. App. 615, 984 P.2d 917 (1999), a dispute arose over a dentist's claims for disability. Following the dentist's sale of his practice, plaintiff submitted a notice of disability claim for various damages, including the new owner's overhead expenses that the plaintiff agreed to pay on behalf of the new owner of the dental practice. But the definition of covered expenses did not include such overhead expenses. The trial court granted summary judgment to the insurer on coverage and on the dentist's claims for breach of the duty of good faith and fair dealing. The court found that the plaintiff was "correct that it is possible for an insurer to breach the duty of good faith without also breaching the insurance contract." *Richardson* at 624, 984 P.2d at 923. The court also found, however, that "any implied covenant of good faith and fair dealing must be consistent with the terms of a contract…." *Id.* Because the covenant of good faith the plaintiff sought to imply "would be inconsistent with the coverage provisions of the policies," the appellate court affirmed the trial court's grant of summary judgment for the insurer.

In *Best Place, Inc. v. Penn America Ins. Co.*, 82 Haw. 120, 920 P.2d 334 (1996), the claims arose out of a denial of a fire claim. The insurer suspected the claimants of arson in connection with a night club fire and accordingly refused to pay—insisting that the claimants provide additional documentation and submit to an examination under oath. In *Best Place*, a Hawaii court for the first time recognized a bad faith cause of action in the insurance context. The court likewise found that the tort of bad faith is separate and distinct from "tortious breach of contract" claims and found that "an insurer could be liable for the tort of bad faith for certain conduct where it would not be liable for a tortious breach of contract." *Best Place* at 131, 920 P.2d at 345. "The breach of the express covenant to pay claims, however, is not the *sine qua non* for an action for breach of the implied covenant of good faith and fair dealing." *Id.* at 132, 920 P.2d at 346. Additionally, the court found that the appropriate test for bad faith is not "conscious awareness of wrongdoing" or "evil motive or intent to harm;" rather, "unreasonable delay in payment of benefits will warrant recovery for compensatory damages…." *Id.* at 133, 920 P.2d 347. However, "something more" such as wanton or malicious conduct is required for an award of punitive damages. *Id.* at 134, 920 P.2d at 348. The court vacated the motion in limine granted for the defendant insurer on the issue of bad faith and returned the matter to the trial court.

## Conclusion

The attorney for the insurer confronted with a bad faith claim should be diligent in testing the breach of contract claim. Does your jurisdiction follow the majority or minority position? Should no breach of contract claim exist, or should it be dismissed, the defense attorney should be quick to move for the bad faith claim to be dismissed as well. In instances where a breach of contract claim will survive pretrial motions, thought should be given to whether bifurcation of the claims—where the breach of contract claim is heard first—would be appropriate. In any event, a bad faith claim, accompanied by a trebled or punitive damages demand, raises the stakes in insurance coverage litigation, but a well-prepared defense attorney playing his or her best hand can quickly turn the tables on the plaintiff. FD