

Policyholder Playbook Episode 13: Always Consider Bad Faith

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PRACTICES Insurance Recovery, Litigation

Quick Overview of the Play - In every insurance coverage dispute, think about bad faith in a broad sense - *i.e.*, ask whether the insurer behaved “unreasonably” through a coverage position, act, or omission.

The best policyholder advocates consider, in every insurance dispute they handle, whether the insurer arguably acted in bad faith. They think about bad faith not just as, for example, a refusal to settle within policy limits, but as any insurer position, act, or omission that is “unreasonable.” That is because common law often provides that if an insurer behaves unreasonably or contrary to how a reasonable insurer should behave then it has committed bad faith. For example, under Colorado law, the common law bad faith test is whether the insurer knowingly acted unreasonably, with reasonableness measured by what a “reasonable insurer under the circumstances” would or would not have done. *Zbegner v. Allied Prop. & Cas. Ins. Co.*, 455 F. App’x 820, 826 (10th Cir. 2011). In California, the test is whether, in wrongfully denying coverage, “the insurer acted unreasonably.” *Love v. Fire Ins. Exch.*, 221 Cal. App. 3d 1136, 1151 (Cal. Ct. App. 1990).

We recently handled a case governed by Oklahoma law where a similar common law standard applied. We argued the insurer acted in bad faith when it denied coverage based upon an argument it knew was meritless. We alleged the insurer knew its argument was meritless because it had advanced the same argument in another jurisdiction and had lost. And although the issue was a matter of first impression in our jurisdiction, most insurance claims handlers will agree—particularly before a jury—that the benefit of the doubt must go to the insured. We accordingly planned to ask the jury whether it is reasonable for an insurer to deny coverage based upon an argument it had previously lost when the benefit of the doubt must go to the insured.

An October 2023 decision issued by a California federal court supports the same way of thinking. In *Sempre Energy v. Associated Electric & Gas Ins.*, the court held the policyholder pled a viable bad-faith claim upon its allegation that the insurer’s “lone explanation for its refusal to indemnify was flatly inconsistent with evidence timely submitted to it by the [policyholder].” No. 19-cv-3340, at *7. (C.D. Cal. Oct. 16, 2023). Specifically, the policyholder alleged its insurer denied coverage upon an assertion that no injury occurred during its policy period, yet the policyholder alleged it provided its insurer with evidence of injury during its policy period. *Id.* at *6–7. Upon that sequence, the court denied the insurer’s motion to dismiss the bad-faith claim. *Id.* at *7.

If a policyholder is forced to litigate coverage and has a viable bad-faith theory—like in our Oklahoma case and in *Sempre Energy*—pleading a corresponding bad-faith claim may offer several advantages. For example, in some jurisdictions, it may be easier for the policyholder to obtain key discovery like its insurer’s reinsurance communications, or reserves, if the policyholder has asserted a bad-faith claim. See, e.g., *Scottsdale Ins. Co. v. Universal Crop*, No. 07-cv-3526, 2008 WL 11411780, at *2 (D. Minn. Oct. 20, 2008) (“The starting place for this Court’s decision is that ... reserve information and the reinsurance documents are only discoverable where claims of bad faith

have been asserted.”). Perhaps more importantly, prevailing on a bad-faith claim may entitle the insured to extracontractual relief, like the recovery of its attorneys’ fees. *First Nat’l Bank v. Fid. & Deposit Ins. Co. of Maryland*, 196 F.3d 1186, 1189 (10th Cir. 1999) (noting “the common law right to attorney’s fees where bad faith is shown” under Oklahoma law). For those and other reasons, the best policyholder advocates always consider whether the insurer arguably acted in bad faith.

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