THE "GOOD," THE "BAD" AND THE "UGLY:" THE TREASURE BURIED IN MINNESOTA'S BAD FAITH LAW

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Before embarking on any journey, it is helpful to understand what it is one seeks, where the destination is located, and how does one get there. Whether in a physical, metaphysical or legal sense, these axioms allow one to keep focused on the reason for the journey. The encounters along the way may make the journey interesting and memorable, and shape the journey's success.

This article takes a step back from current analysis of third party "bad faith" failure to settle cases to revisit some basic concepts of what really is "good faith," "bad faith," and what is exactly necessary to establish a carrier's liability for a verdict amount in excess of policy limits. Stated another way, at what point on the continuum of conduct does the "lack of good faith," or "bad faith," becomes actionable. By no means do the following pages answer this question. Instead, this discussion is intended to take a fresh look at Minnesota "bad faith" failure to settle cases to perhaps reassess how these cases are analyzed and handled.

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At its most elemental level, "bad faith" is defined as "[d]ishonesty of believe or purpose." *Black's Law Dictionary* (Deluxe Eighth Edition 2004), p. 149. *Black's* goes on to define "bad faith" in an insurance context as follows:

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[1] These materials are educational in that the content is intended to encourage discussion and interaction. The views expressed in the following pages are not necessarily those of the author, Johnson & Condon, P.A., or their clients.

> "An insurance company's unreasonable and unfounded (although not necessarily fraudulent) refusal to provide coverage in violation of the duties of good faith and fair dealing owed to an insured."

Id. This definition in turn raises the question: What is "good faith" (and "fair dealing)?" *Black's* to the rescue once again. "Good faith" is defined as :

> "A state of mind consisting of (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage."

Id. at p. 713. "Fair dealing" is defined as:

> "2. A fiduciary's transacting of business so that, although the fiduciary might derive a personal benefit, all interested persons are fully apprised of that potential and of all other material information about the transaction."

Id. at p. 633.[2]

The *Restatement (Second) of Contracts* is even less precise when discussing these concepts. For example, the *Restatement (Second)* describes "bad faith" as follows:

> "A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of the power to specify terms, and interference with or failure to cooperate in the other party's performance."

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[2] The first definition of "fair dealing" states: "1. The conduct of business with full disclosure, usu. by a corporate officer with the corporation."

Id. at §205 cmt. d (1979). The *Restatement (Second)* does no better with "good faith," either:

> "the phrase 'good faith' is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes of our riot he of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for breach of the duty of good faith also varies with the circumstances."

Id. at §205 cmt. a (1979).

Apart from the Stewartesque inexactness of the definitions themselves,[3] the inability to define either of these terms raises several questions. Are there two sides to the coin – "good faith" and "bad faith?" Or, is there a third category to consider in the analysis which is the limbo-like conduct, regardless of the conduct being honest or dishonest, or consisting of malfeasance or nonfeasance, which does not fit within these two light switch-like categories? Moreover, if this third category of cases exists, should liability be imposed in every case fitting within this category simply because a carrier fails to achieve complete good faith, or is there another factor Minnesota courts look at to determine whether cases within this third category may expose the carrier to consequential damages in an amount in excess of a liability verdict?

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[3] "I know it when I see it . . . ." Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring). These materials leave for another day the reasons why these terms cannot be defined with precision.

Given human nature and the ingenuity of counsel, it is likely few if any cases will ever involve facts where each aspect of a carrier's claim handling will satisfy everyone's definition of "good faith." Conversely, the same can be said about cases where every aspect of a claim's handling exhibited a deliberate, egregious effort by the carrier to avoid payment – such cases are few if ever encountered. Therefore, it appears the vast majority of litigated "bad faith" failure to settle cases involve fact patterns which fall into this third, middle category. However not all such cases result in liability to the carrier for the excess amount of the verdict. What then do Minnesota courts weigh in order to resolve whether a carrier has liability in excess of policy limits when conduct is less than complete good faith at every turn?

A careful reading of Minnesota "bad faith" failure to settle within policy limits common law precedent reveals a subtle but important pattern which should guide practitioners litigating these cases. It appears the supreme court will find bad faith only if the carrier engaged in some overt affirmative bad act(s), or obviously reckless act(s), while handling a liability action which results in an excess verdict. Therefore, in cases where an insurer handles a matter pursuant to usual and prudent business practices, the carrier should not face a consequential damage exposure in an amount in excess of a liability verdict. Stated another way, even where the carrier exercises less than good faith in every aspect of its claim handling, the carrier should not be liable for "bad faith" unless some kind of "bad acts" are established.

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IS "BAD FAITH" ESTABLISHED WHENEVER THERE IS SOME LACK OF "GOOD FAITH?"

It has been proposed that bad faith is not necessarily the polar opposite of good faith. Such a proposition is necessary to support a theory that a liability insurer "should" be liable for damages in excess of policy limits even if it has not acted with ill will or malicious motives. This "less than utmost good faith" concept might have been the motivation for the trial court to find that carriers breached their implied covenants of good faith and fair dealing in In Re; Silicone Breast Implant Coverage Litigation, 652 N.W.2d 46 (Minn. Ct. App. 2002), reversed in part, affirmed in part, 667 N.W.2d 405 (Minn. 2003). The court of appeals observed:

> "In an order issued in September 2000, the court made general findings about the insurers' conduct as a group, particularly before the coverage action commenced in 1994, and concluded that the insurers had repudiated their contracts and breached the implied covenant of good faith and fair dealing."

Id. 652 N.W.2d at 55. It appears the trial court was less than satisfied that carriers' requests for information about the mass tort unfolding prior to the coverage action's commencement evidenced "good faith and fair dealing," despite the fact the carriers required the requested information to determine each of their obligations within the overall coverage provided to the insured.

The concept of "anything less than utmost good faith" constituting bad faith is also illustrated in a passage in Buysse v. Baumann-Furrie & Co., 448 N.W.2d 865 (Minn. 1989):

> "Good faith and fair dealing between insurer and insured are, of course, correlative obligations, Larson v. Anchor Cas. Co., 249 Minn. 339, 353, 82 N.W.2d 376, 385 (1957), and this guideline has

> been set for the governance of the conduct of insurer and insured under circumstances like those encountered in the present case:
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>> '"Where a claim is made against an insured which may exceed policy limits, and where the insured and insurer may each incur liability, then each assumes an obligation to act in good faith, to face the facts realistically, and to maintain a mutual respect for the interests of the other.'
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> "Sargent v. Johnson, 551 F.2d 221, 231-32 (8th Cir.1977)." * * * In Sargent the Court of Appeals went on to hold that by entering into a settlement agreement without the concurrence or consent of its insurance carrier an insured had not only breached the insurance policy but had also ***failed to deal with its insurer in good faith***, thereby effectively severing the insurer-insured relationship. Id. at 232."

Id. at 873-74 (emphasis added) (footnote omitted). This passage implies that a party's less than complete good faith in its dealings can have legal consequences. However, the court was unwilling to implement such a stringent standard:

> "Although ***we are disinclined to characterize Baumann-Furrie's entry into the settlement stipulation as bad faith conduct***, we do recognize that the insured's conduct amounts to a breach of contract which voids coverage if it is material and prejudicial. Juvland v. Plaisance, 255 Minn. 262, 268-69, 96 N.W.2d 537, 541-42 (1959)."

Id. (emphasis added).[4] This passage clearly signals that conduct which is "less than good faith" will not impose "bad faith" consequences on a party.

[4] The court then went on to say the agreement between the parties essentially conceded there would be $500,000 in coverage no matter the outcome, thereby avoiding the issue of whether the insured's not-quite good faith conduct voided the admitted coverage.

If "less than good faith" conduct does not always impose legal consequences, then what will the courts look to in order to determine when a party is in "bad faith?" Caselaw suggests "bad faith" will not be found unless there is some overt negative conduct, or possibly reckless conduct, exhibited by the breaching party. See e.g., Zurich Reins. (UK) Ltd. v. Canadian Pacific Ltd., 613 N.W.2d 760, 765 (Minn. Ct. App. 2000) ("[A]greeing to a settlement despite an insurer's opposition ***does not amount to bad faith in the absence of evidence of intent to defraud or collude***." (emphasis added), review denied (Minn. Sept. 26, 2000); Hawkins, Inc. v. American Int'l Specialty Lines Ins. Co., 2008 WL 4552683 at * 10 (Minn. Ct. App. 2008) (insurer not in bad faith by weighing whether to ask an insured to contribute to a settlement), review denied (Minn. Dec. 23, 2008). The question becomes whether this dichotomy exists in Minnesota Supreme Court "bad faith" failure to settle caselaw.

The current lead case which addresses an insurer's liability for a verdict in excess of policy limits is Short v. Dairyland Ins. Co., 334 N.W.2d 384 (Minn. 1983). As an aside, Short is an interesting opinion in that the substance of the decision was not written by the supreme court; instead, the court adopted and published the trial court's memorandum as the supreme court's opinion.

Several passages in Short imply that an insurer's exercise of less than complete good faith may be actionable:

> "In Minnesota, a liability insurer, having assumed control of the right of settlement of claims against its insured, may become liable in excess of its undertaking under the terms of the policy if it ***fails to exercise 'good faith'*** in considering offers to compromise the

> claim for an amount within the policy limits. Lange v. Fidelity & Casualty Co., 290 Minn. 61, 185 N.W.2d 881 (1971); Larson v. Anchor Casualty Co., 249 Minn. 339, 82 N.W.2d 376 (1957)."

Id. at 387 (emphasis added).

> "The insurer's ***duty of good faith*** is breached in situations in which the insured is clearly liable and the insurer refuses to settle within the policy limits and the decision not to settle within the policy limits ***is not made in good faith*** and is not based upon reasonable grounds to believe that the amount demanded is excessive. See Peterson v. American Fam. Mut. Ins. Co., 280 Minn. 482, 486, 160 N.W.2d 541, 543 44 (1968); Boerger v. American Gen. Ins. Co., 257 Minn. 72, 74 75, 100 N.W.2d 133, 135 (1959).

Id. at 388 (emphasis added). This "good faith" – "less than good faith" dichotomy continues in the opinion. However, the decision hints that something more than "less than good faith" is necessary to establish bad faith:

> * * * Dairyland complains that it was under no absolute duty to accept the settlement demand of March 31, and that it was entitled to 'explore' the possibility of settlement for less than the full policy limits. While this may be true, such 'exploration' might ***lead to a finding of bad faith***, and in the instant case, that it was [what] this Court has found. To characterize Dairyland's brazen attempts to obtain a discount as "exploring" the possibility of settlement for less than the full policy limits is specious and overlooks Dairyland's primary responsibility its insured. Not only did Dairyland attempt to obtain a discount, but also attempted to coerce Morin's attorney into submission by raising the spectre of State Farm's subrogation rights should Morin seek to submit her claim to the jurisdiction of the courts. If such actions do not constitute ***lack of 'good faith,'*** this Court is unable to imagine why."

Id. (emphasis added). Ultimately, the Short trial court determined the carrier's efforts to extract a discount off the minimal policy limits ($25,000) over an extended period of time in an obvious excess verdict situation ($745,000 in damages in a drunk driving accident) constituted bad faith conduct.

Short in retrospect certainly seems to be an example of egregious conduct by the carrier which, at a minimum, appears reckless and obviously self-serving. What also appears plain is the decision does not stand for the proposition that any conduct less than complete good faith imposes liability on an insurer for a verdict in excess of policy limits. In this respect, Short is consistent with the line of cases cited in the decision which, at a minimum, suggest some overt negative "bad faith" conduct is required before liability in excess of applicable policy limits will attach.

The oldest case relied upon by Short is Larson v. Anchor Cas. Co., 249 Minn. 339, 82 N.W.2d 376 (Minn. 1957). Larson describes the Minnesota standard in "failure to settle" matters as the imposition of liability based on the "failure to exercise good faith," but with an explanation of what this phrase means:

> "It is clear that Minnesota has adopted the rule that a liability insurer, having assumed control of the right of settlement of claims against the insured, may become liable in excess of its undertaking under the policy provisions if it ***fails to exercise 'good faith'*** in considering offers to compromise the claim for an amount within the policy limits.
>
> "We are clearly committed to the 'good faith' test and that ***there must be bad faith*** with resulting injury to the insured ***before there can be a cause of action.***
>
> "Where a conflict of interest arises between the insurer and the insured with respect to the action of an insurer under a policy of public liability wherein it has reserved the alternative right to

> defend or to make settlement, but where good faith and fair dealing are also correlative obligations between the insurer and the insured, a liability insurer is entitled to an honest statement by the insured and the insured to the insurer's good faith where accepting or rejecting a compromise offer is involved. A defense, however, showing reasonable and probable cause for rejecting the compromise offer vindicates the insurer's good faith, even though the defense is unsuccessful.
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> "We reach the conclusion in the instant case that Anchor had, under all the circumstances, reasonable and probable cause for rejecting the compromise offer; that its actions and conduct throughout the whole course of its proceedings in the LeTourneau-Larson controversy ***survive the good-faith test, there being no bad faith on the part of Anchor which resulted in injury to its insured.***"

Id. at 355-56, 82 N.W.2d at 386-87 (emphasis added). Despite some slight irregularities in the handling of the claim and the lawsuit, the court in the end did not find egregious facts reflective of deliberate or reckless conduct warranting a finding of bad faith:

> "We are forced to reject, upon the record herein, Larson's claim that he became the victim of bad faith by any act or conduct on the part of Anchor, the insurer, or that in its exercise of its right to defend it ***knowingly or intentionally did so against his interests***."

Id. at 350, 82 N.W.2d at 383 (emphasis added). Since the carrier did not commit overt bad acts, there was no violation of the "good faith" standard.

Short also cited Boerger v. American Gen. Ins. Co., 257 Minn. 72, 100 N.W.2d 133 (1959), specifically for the following proposition:

> "We are of the opinion that the insurance company could have validly declined the offer of settlement ***if good faith existed*** on either of two grounds. First, if it ***in good faith believed*** that its insured was not liable. Second, even if liability of its insured was

> certain, if it ***believed in good faith*** that a settlement at the proposed figure which it was required to contribute was greater than the amount the jury would award as damages.

Id. at 75, 100 N.W.2d at 135 (emphasis added) (cited in Short, 334 N.W.2d at 388). This passage at first blush seems to imply that anything less than "good faith" may be actionable. In Boerger, this is perhaps a true statement and therefore makes this case difficult to reconcile within the Minnesota "failure to settle" caselaw.

Boerger involved an automobile collision at an uncontrolled intersection between a taxi cab and another vehicle which had the right of way. The cab's passenger was killed in the accident. At the close of evidence, the plaintiff's counsel stated he would accept the $10,000 policy liability limits, plus a $2,000 note from the insured (who was willing to provide the note) to settle the case. In response the demand, the carrier only offered $8,000, and an excess verdict was returned. In the subsequent "bad faith" litigation, the jury found the carrier was in "bad faith." However, the appeal did not address any issue other than whether the evidence was sufficient to sustain the verdict, a very deferential review standard. Id. at 74, 100 N.W.2d at 135.

The court determined there would not be a realistic chance the insured would escape a liability determination given the higher duty of care owed by common carriers to their passengers. As well, the excess verdict amount was within the range of damages which could have been realistically awarded. Therefore, the court held the evidence supported the verdict. It is possible this would have been a more difficult consideration for the court if it weren't for a comment quoted in the opinion which was purportedly uttered by appointed defense counsel:

> "'Well, the most we can lose, in any event, is $10,000.00; regardless of how this case goes,' and 'so why should we pay that out in settlement, if that's the most we can lose, regardless of what happens.'"

Id. at 77, 100 N.W.2d at 136. Therefore, while the opinion does not discuss specific overt bad acts by the carrier, it seems such a comment raises the specter of such conduct. Given the limited nature of the appellate review, there did not need to be additional recitations of carrier conduct to sustain the verdict.

The third case Short cites is Peterson v. American Fam. Mut. Ins. Co., 280 Minn. 482, 160 N.W.2d 541 (1968). In Peterson, the court concluded the carrier was not in bad faith by the failure to offer the liability policy limits to settle the case. The court initially discussed the insured's enthusiastic objections to any settlement as the insured insisted he was not at fault. The court then summarized the legal principles at issue:

> "The law on the question of an insurer's liability for failing to effect a provident settlement is well settled in this state. Mendota Elec. Co. v. New York Ind. Co., 169 Minn. 377, 380, 211 N.W. 317, 318; Id. 175 Minn. 181, 221 N.W. 61; Lawson & Nelson Co. v. Associated Ind. Corp., 204 Minn. 50, 282 N.W. 481; Larson v. Anchor Cas. Co., 249 Minn. 339, 355, 82 N.W.2d. 376, 386; Boerger v. American General Ins. Co., 257 Minn. 72, 100 N.W.2d 133. Where the insured is clearly liable and the insurer refuses to settle within the policy limits, its ***decision must be made in good faith*** and it must have reasonable grounds to believe that the amount demanded for settlement is excessive. ***A mere mistake in judgment does not, standing alone, constitute bad faith.*** 'No mortal has the gift of prophecy.'[FN2] The insured has the ***burden of proving that the insurer acted in bad faith*** in rejecting an offer of settlement within the policy limits.

> "FN2. '* * * We do not believe the ***test of bad faith*** should be determined by hindsight.' Hodges v. Standard Acc. Ins. Co., 198 Cal.App.2d 564, 575, 18 Cal.Rptr. 17, 24."

Id. at 485-86, 160 N.W.2d at 543-44 (emphasis added). Given the facts of the case, the court observed:

> "In the ***absence of any probative evidence that the insurer misled*** Johnson with respect to his vulnerability, it is clear that it was his voluntary and considered decision to try the case. Under these circumstances, it can hardly be claimed that his insurer is liable to him for not having insisted upon a settlement within the policy limits. The ***gravamen of an insured's claim for bad faith*** in refusing to settle is a showing that the insured had demanded the insurance company accept an offer within the policy limits and that ***the company was arbitrary in refusing to do so***, subverting the insured's interests to its own."

Id. at 486, 160 N.W.2d at 544 (emphasis added). Given this language, it appears the court was examining the record to determine if the carrier's conduct was arbitrary or exhibited a misrepresentation, either of which would constitute overt bad acts upon which to base a "bad faith" finding. Seeing none, it appears the court did not have any difficulty in ruling for the carrier.

Overt bad conduct is seen in Lange v. Fidelity & Casualty Co., 290 Minn. 61, 185 N.W.2d 881 (1971), the last of the four cases cited in Short. Lange involves a claim against an insurer which refused a settlement within policy limits, even after an excess verdict was returned against the insured. It appears the insurer in part defended the policyholder by asserting a contribution action against a third party. An excess verdict was returned, and the appointed defense counsel never appealed (nor intended to appeal) the denial of post-trial motions.

However, the third-party defendant did appeal the contribution verdict, which the supreme court ordered to be retried as to liability. In the meantime, the carrier paid its policy limits to the plaintiff, but left the amount of the excess verdict unsatisfied. During the retrial, the carrier settled the contribution claim in the amount of the verdict in excess of the policy limits. However, for some reason, the carrier did not then pay the contribution claim settlement over to the Plaintiff to satisfy the excess judgment against the policyholder.

In light of this frankly bizarre fact pattern, the court analyzed the carrier's legal duties. "[T]he insurer ***must exercise good faith*** in considering settlement offers." Id. at 64, 185 N.W.2d at 884 (citing, as did Short, Peterson and Boerger). "***[T]here must be bad faith on the part of the insurer*** with resulting injury to the insured before there can be a cause of action against the insurer for the excess over its undertaking." Id. at 64-65, 185 N.W.2d at 884 (emphasis added) (citing Larson). By referring to "bad faith," and given the relied-upon caselaw, it appears the court was looking for an overt bad act to impose liability on the carrier. This was not difficult. The carrier's decision to keep the contribution action settlement resulted in the carrier's net payout being less than its policy limits, and left the policyholder with a personal judgment in the same amount which the carrier obtained in the contribution action settlement. It is fairly easy to see why this constituted bad conduct by the insurer sufficient to impose liability.

Cases subsequent to Short have not necessarily adhered to the requirement that the carrier must engage in overt bad acts or reckless acts before "failure to settle" liability is found. For example, in Kissoondath v. United States Fire Ins. Co., 620 N.W.2d 909 (Minn. Ct. App. 2001), review denied (Minn. April 17, 2001), the court of appeals determined that the carrier's failure to fulfill even one obligation involved with carrier's good faith duty to its insured can be the basis to impose bad faith liability if the policyholder is clearly liable. Id. at 916. In light of this determination, the court stated:

> "The record demonstrates that respondent failed to materially inform and continually communicate with insured regarding the settlement offer and the likelihood of an excess verdict. Respondent's counsel only advised insured of a 'theoretical risk' of an excess verdict, when in fact he was obligated to advise insured, in detail, as to the implications of an excess verdict."

Id. at 919 (citing Lange, 290 Minn. at 68, 185 N.W.2d at 886). This became the basis on which a new trial was ordered, and ultimately a summary judgment against the insurer on the bad faith issue. Kissoondath v. United States Fire Ins. Co., 2002 WL 31749100 (Minn. Ct. App. 2002).

It is somewhat difficult to reconcile Kissoondath with the supreme court precedent. The policyholder apparently stated, even after the excess verdict, that additional information would not have changed his decision to go to trial. 2002 WL 31749100 at * 4. The court rejected this hindsight statement as speculation in that it did not impact the question of what the insured would have done before trial if he had been fully informed about the possibility of an excess judgment. Id. However, it seems a post-verdict statement such as this is similar to statements made by the policyholder in Peterson where the insurer was not found to be in bad faith. As well, there is no reference in the Kissoondath opinions that the carrier requested or intimated that status reports not go to the policyholder, or any other conduct the carrier engaged in to tip the case from a "lack of exercise of good faith" to one where liability is based on "bad faith" conduct.

A recent decision which more closely fits the supreme court's analysis is Hawkins, Inc. v. American Int'l Specialty Lines Ins. Co., 2008 WL 4552683 (Minn. Ct. App. 2008), review denied (Minn. Dec. 23, 2008). Hawkins involved an insured's attempt to recoup $3 million it voluntarily contributed to a $4.2 million settlement involving an injury due to a mislabeled drug. Throughout the litigation, appointed defense counsel kept the insured informed of the case's progress and developments, settlement demands, negotiations, and mediations (which the insured personally attended); the insured was well informed of the threat of punitive damages, and an appreciation that punitive damages would not be covered. Id. at *2. However, it appears the carrier never sent a reservation of rights letter to the insured stating punitive damages were not covered. Id. at *11. As well, the carrier considered asking the insured to participate with settlement dollars given the settlement demands clearly contemplated payment of punitive damages. Id. at *10.

The court of appeals conducted an exhaustive analysis of the case's complex and detailed facts, and had no trouble affirming the trial court's determination that bad faith did not exist under this fact pattern as a matter of law. None of the carrier's conduct in extending a defense to the insured, even in the face of a late conflict of interest arising between the two defendants, exhibited any overt bad acts or otherwise reckless conduct sufficient to impose bad faith liability. Id. at *6-*8. The same was true as to the carrier's duty to indemnify, even though no reservation letter was issued, and the carrier considered asking the insured to contribute settlement dollars. Id. at *8-*11. Especially as to these two factors, it seems the court did not consider this conduct to be sufficiently egregious to constitute bad faith.

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Obviously, a carrier should never tempt fate when addressing "failure to settle" liability limit cases.[5] Prudent and rational claims handling, honest assessment of a case's merits, and the absence of any cavalier approach to the case will serve the carrier well. However, if faced with this type of "bad faith" claim, a carrier should not presume the standard for liability is a "failure to exercise good faith." Minnesota precedent supports the proposition that a "bad faith" determination must be based on some type of specific overt bad act(s) or reckless act(s) before liability can be imposed for a verdict in excess of policy limits.

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[5] It is entirely possible a carrier's reliance on this article to justify sloppy or sub-par claims handling could, in and of itself, constitute the type deliberate bad act discussed above to justify a bad faith finding.