Written by Madeleine Fischer in connection with National Business Institute Seminar, LESSONS LEARNED FROM KEY BAD FAITH COURT RULINGS, presented June 12, 2012 at New Orleans, Louisiana

OVERVIEW OF GENERAL BAD FAITH PRINCIPLES -- LOUISIANA

Louisiana's current law of bad faith is embodied in two statutes, La. R.S. 22:1892 and La. R.S. 22:1973. Both statutes were renumbered beginning in 2009 and most of jurisprudence refers to them by their original numbers La. R.S. 22:658 and La. R.S. 22:1220.

LA. R.S. 22:1892

History

La. R.S. 22:1892 (formerly La. R.S. 22:658) originated in 1908 as a penalty applicable to fire insurers. The statute required payment to the insured within 60 days of presentation of satisfactory proof of loss and demand. If the insurer did not pay, it was subject to a 12% penalty plus reasonable attorneys fees. The statute was later expanded to apply to all types of insurance, save life, health and accident policies. The payment period, the amount of the penalty and the applicability of attorneys fees have varied over the years. The statute has survived repeated constitutional challenges. As the Louisiana Supreme Court succinctly observed in *Hammett v. Fire Ass'n of Philadelphia*, 160 So. 302 (La. 1935):

> We fail to see where the statute is oppressive, arbitrary, or confiscatory, when all it seeks to do is to compel the insurance company to pay a just and legal obligation within a reasonable period of time; *i.e.*, 60 days.

Current version

The current version, La. R.S. 22:1892, provides that the insurer must pay any claim due any insured within *30 days* after receipt of satisfactory proofs of loss. The field of potential beneficiaries of the penalty provisions has been expanded, so that now an insurer is required to make a written offer to settle any property damage claim, *including one brought by a third party*, within 30 days of satisfactory proof of loss.

Failure to make payment or an offer of settlement within 30 days as required now subjects an insurer to a penalty of *50%* of the amount due (with a minimum of $1,000) plus reasonable attorneys fees and costs, but only if the failure is found to be arbitrary, capricious or without probable cause.

In 1989 a seemingly innocuous provision was added to the statute requiring that an insurer initiate loss adjustment of property damage and medical expense claims within 14 days after notification of loss by the claimant, except in case of catastrophic loss. This was eventually clarified to set the time period for loss adjustment in case of catastrophic loss at 30 days and to provide that failure to comply subjected the insurer to the penalties provided by La. R.S. 22:1973 (formerly La. R.S. 22:1220).

Failure to timely initiate loss adjustment

The loss adjustment penalty sprang to life after Hurricanes Katrina and Rita. In *Oubre v. Louisiana Citizens Fair Plan*, No. 2011-0097, 2011 WL 6379956 (La. Dec. 16, 2011), the Louisiana Supreme Court reinstated a trial court judgment of over $92 million in favor of a class of homeowners whose post-hurricane property damage claims had not been promptly addressed by Louisiana Citizens Fair Plan, Louisiana's state-run insurer of last resort. The court held that the language of subsection (A)(3) of the statute, particularly its use of the word "shall," meant that an insurer *must* initiate loss adjustment within thirty days, and if the insurer does not, the imposition of a penalty is mandatory. The court particularly noted that there was no reference to good or bad faith in this particular part of the statute. The insurer's inaction alone triggered the penalty. Further, requiring proof of bad faith would interfere with the statute's goal of encouraging insurers to timely commence loss adjustment with their insureds. The court rejected the argument that the extreme circumstances of the hurricanes excused the delay. Specifically, the court noted that the delay for initiation of loss adjustment in non-catastrophic cases was 14 days, as opposed to the 30 days allowed in catastrophic cases. Accordingly, the statute already took into account the difference in circumstances when losses are caused by a major catastrophe.

In 2009, the Louisiana Legislature amended (A)(3) to allow the Commissioner of Insurance to extend the delay for initiating a loss adjustment for damages arising from a presidentially-declared emergency or disaster or a gubernatorially-declared emergency or disaster up to an additional 60 days.

Arbitrary, capricious or without probable cause

A case from 2008 from the Louisiana Supreme Court sets a concerning precedent for insurers about the standards for bad faith: *Louisiana Bag Co., Inc. v. Audubon Indem. Co.*, 2008-0453 (La. 12/2/08), 999 So. 2d 1104. In *Louisiana Bag*, the insured's manufacturing plant and warehouse facilities were destroyed by fire. Early on, the adjuster informed the insurer that the loss would exceed policy limits, but questions remained about the type of coverage and the extent of the loss. The insurer made payment of full limits, less an advance, six months after the point in time when it was deemed the insurer had sufficient information to pay.

The Louisiana Supreme Court affirmed the intermediate court of appeals' decision that penalties were in order under the penalties statute then in effect, La. R.S. 22:658 (now 22:1892). The following are the essential holdings of the Louisiana Supreme Court's opinion:

- While an insurer need not tender payment for amounts that are reasonably in dispute, "there can be no good reason " – or no probable cause – for withholding an undisputed amount. Where there is a substantial, reasonable and legitimate dispute as to the extent or amount of the loss, the insurer can avoid the imposition of penalties only by unconditionally tendering the undisputed portion of the claim. An insurer cannot "stonewall" an insured simply because the insured is unable to prove the exact extent of his damages.
- An insurer "must take the risk of misinterpreting its policy provisions," and if an insurer "errs in interpreting its own insurance contract, such error will not be considered as a reasonable ground for delaying payment of benefits, and it will not relieve the insurer of the payment of penalties and attorney's fees. Therefore, The insurer cannot avoid the payment of penalties for delay in tendering payment

within the statutorily mandated time period by reason of its interpretation of the coverage afforded by its policy.

- A "satisfactory proof of loss" is only that which is "sufficient to fully apprise the insurer of the insured's claims." The proof of loss requirement is flexible. An insurer's requirement that it receive its form of proof of loss before payment is insufficient to create probable cause to delay payment. To permit an insurer to insist upon its own proof-of-loss form would frustrate the intent and purpose of La. R.S. § 22:658 because it would allow the insurer to be solely in control of when proof of loss is received.
- An insured need not identify any specific conduct by the insurer that was arbitrary, capricious or without probable cause. Proof of specific acts or proof of the insurer's state of mind is generally not required to establish conduct that is arbitrary, capricious or without probable cause.

It appears that the best grounds to avoid penalties would be to argue that the insurer had a good faith disagreement with the insured over the cause and the extent of the loss. Arguing that there was a dispute over the legal interpretation of the policy language will only work if you win that argument, according to *Louisiana Bag*.

LA. R.S. 22:1973

State of the law before enactment of La. R.S. 22:1973

La. R.S. 22:1973 (formerly La. R.S. 22:1220) is a relative newcomer in comparison to La. R.S. 22:1982, but many of the principles it embodies are not new. Long before the enactment of La. R.S. 22:1220, Louisiana case law recognized that an insurer owes a duty of good faith to its insured.

An important early case in establishing the duty of good faith is the Louisiana Supreme Court's decision in *Roberie v. Southern Farm Bureau Cas. Ins. Co.*, 194 So. 2d 713 (La. 1967). In that auto accident case, the insurer failed to inform the insured of a settlement demand by the plaintiff before trial. The insurer took the case to trial and a judgment in excess of policy limits was rendered. The insured then sued his insurer for the excess judgment. The Supreme Court found that the insurer was not in bad faith in

rejecting the settlement demand and taking the case to trial because liability was in some dispute. But more significantly, the Supreme Court found that the insurer did commit bad faith by failing to keep its insured informed of settlement negotiations:

> We agree with the Court of Appeal that there was no bad faith on the part of the Insurance Company in not compromising the claims filed against it in the Pitre case. It acted within the terms of its insurance contract in proceeding to trial, and, under the facts supra, its actions could not be considered arbitrary, i.e., it preferred litigation to compromise. However, the insured, Roberie, was kept in the dark; he was never apprised of the offers of compromise nor warned of his potential liability; he was ignored. He needed information and advice on the point of his potential liability, which he was not given by his representative, his insurer. A conflict of interest arose between the insurer and the insured. The insurer failed to discharge its duty towards its insured, thereby precluding any decisive action on his part. We find that the actions of Southern Farm Bureau Casualty Insurance Company towards Roberie were more than negligent; they were in bad faith and in utter disregard of Roberie's natural desire to protect himself from financial loss.

Id. at 115.

In *Pareti v. Sentry Indem. Co.*, 536 So. 2d 417 (La. 1988), the Louisiana Supreme Court discussed the parameters of the insurer's duty of good faith when paying out limits and terminating a defense. While the court held that under the facts and circumstances of the case the insurer had acted in good faith in settling, the court went on to explain:

> The concern that in some cases an insurer might attempt to circumvent its duty to defend the insured by making an "early escape" from the litigation is a valid one. However, in order to safeguard against the risk that insurance companies will enter inappropriate settlements in some cases, it is not necessary for us to void an unambiguous contractual provision. Instead, the protection afforded to insureds against this contingency is that in every case, the insurance company is held to a high fiduciary duty to discharge its policy obligations to its insured in good faith-including the duty to defend the insured against covered claims and to consider the interests

> of the insured in every settlement. See *Holtzclaw v. Falco*, 355 So. 2d 1279 (La. 1977); *Richard v. Southern Farm Bureau Cas. Ins. Co*., 254 La. 429, 223 So. 2d 858 (La. 1969); *Reichert v. Continental Ins. Co*., 290 So. 2d 730 (La. App. 1st Cir.), *writ denied* 294 So. 2d 545 (1974); *Younger v. Lumbermens Mutual Cas. Co.*, 174 So. 2d 672 (La. App. 3rd Cir.), *writ denied*, 247 La. 1086, 176 So. 2d 145 (1965).
>
> When multiple claims are filed against the insured that have the potential for exceeding the insurer's policy limits, the insurer must act in good faith and with due regard for the insured's best interest in considering whether to settle one or more of the claims. *Holtzclaw*, 355 So. 2d at 1279; *Richard*, 223 So. 2d at 858. An insurer which hastily enters a questionable settlement simply to avoid further defense obligations under the policy clearly is not acting in good faith and may be held liable for damages caused to its insured. *See Sutton Mutual Cas. Co. v. Rolph*, 109 N.H. 142, 244 A.2d 186, 188 (1968); *Lumbermen's Mutual Cas. Co. v. McCarthy*, 90 N.H. 320, 8 A.2d 750 (1939).

Id. at 423. And in addition:

> Further, any payment of the policy limits which does not release the insured from a pending claim (*e.g.*, unilateral tender of policy limits to the court, the claimant or the insured), even if sufficient to terminate the duty to defend under the wording of the policy involved, raises serious questions as to whether the insurer has discharged its policy obligations in good faith.

Id. at 424.

Current version

In 1990 the Louisiana Legislature enacted La. R.S. 22:1220 (now 22:1973). The statute has been amended numerous times. In its current version it now reads:

> **§ 1973. Good faith duty; claims settlement practices; cause of action; penalties**
>
> A. An insurer, including but not limited to a foreign line and surplus line insurer, owes to his insured a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or

> both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.
>
> B. Any one of the following acts, if knowingly committed or performed by an insurer, constitutes a breach of the insurer's duties imposed in Subsection A:
>
> (1) Misrepresenting pertinent facts or insurance policy provisions relating to any coverages at issue.
>
> (2) Failing to pay a settlement within thirty days after an agreement is reduced to writing.
>
> (3) Denying coverage or attempting to settle a claim on the basis of an application which the insurer knows was altered without notice to, or knowledge or consent of, the insured.
>
> (4) Misleading a claimant as to the applicable prescriptive period.
>
> (5) Failing to pay the amount of any claim due any person insured by the contract within sixty days after receipt of satisfactory proof of loss from the claimant when such failure is arbitrary, capricious, or without probable cause.
>
> (6) Failing to pay claims pursuant to R.S. 22:1893 when such failure is arbitrary, capricious, or without probable cause.
>
> C. In addition to any general or special damages to which a claimant is entitled for breach of the imposed duty, the claimant may be awarded penalties assessed against the insurer in an amount not to exceed two times the damages sustained or five thousand dollars, whichever is greater. Such penalties, if awarded, shall not be used by the insurer in computing either past or prospective loss experience for the purpose of setting rates or making rate filings.
>
> D. The provisions of this Section shall not be applicable to claims made under health and accident insurance policies.

Cases have held that La. R.S. 22:1973 did not take the place of existing law, but merely codified it and supplemented it. *See e.g.*, *Lafauci v. Jenkins*, 2001-2960 (La. App. 1 Cir. 1/15/03), 844 So. 2d 19, 30, *writ denied*, 2003-0498 (La. 4/25/03), 842 So. 2d 403;

Gourley v. Prudential Property and Cas. Ins. Co., 98-0934 (La. App. 1 Cir. 5/14/99), 734 So. 2d 940, 944-45, *writ denied*, 99-1777 (La. 10/8/99), 750 So. 2d 969.

Insureds and third parties

In *Theriot v. Midland Risk Ins. Co.*, 95-2895 (La. 5/20/97), 694 So. 2d 184, the Louisiana Supreme Court considered whether the statute applied to third parties or only to insureds. In *Theriot* the middle driver in a three-car accident sued the automobile insurers of preceding and following drivers after they refused to pay the full amount of her claim. The insurers answered and asserted 1) that the duties imposed by La. R.S. 22:1220 run only between the insurer and its insured and do not afford a cause of action to a third-party claimant; and alternatively 2) if a third-party claimant had a cause of action, it was limited to the specific breaches of duty listed in 22:1220(B).

The Supreme Court first concluded that although the first sentence of 22:1220(A) referred only to the insured and was "an outgrowth of the contractual and fiduciary relationship between the insured and insurer," the second sentence specifically mentioned insureds and claimants, indicating that the legislature intended to create a cause of action for third-party claimants in certain circumstances. The court went on to decide, however, that subsection (B) was an exclusive, rather than an illustrative list and the court included some loose language in the opinion which has been read by several courts to extend to both bad faith claims by insureds as well as bad faith claims by third party claimants. A careful reading of the court's extensive analysis, however, indicates that all of the reasons cited by the court for reading 1220(B) as an exclusive – rather than an illustrative – list apply only to third-party claimants and not to the duties owed by an insurer to its own insured.

The Fifth Circuit faced this issue head-on in *Stanley v. Trinchard*, 500 F.3d 411 (5th Cir. 2007) and decided that the listing in 1220(B) was not an exclusive list of ways in which an insurer could breach its duty of good faith to its insured. In *Stanley*, an insurer settled a civil rights action for policy limits without obtaining a full release for its insured. The insured contended this was bad faith, and also that the insurer committed bad faith by failing to advise it of the extent of its continued liability after the settlement.

Eventually, a bankruptcy ensued and the trustee in bankruptcy was substituted for the insured. The district court granted summary judgment for the insurer reasoning that the allegations of bad faith did not fall within the listed actions enumerated in 1220(B). The Fifth Circuit reversed.

Without quoting *Theriot*, the Fifth Circuit examined the reasoning behind *Theriot* and limited *Theriot's* holding to claims by third-party claimants, stating as follows:

> At the conclusion of its extensive analysis, the *Theriot* court ruled that, even though "a cause of action directly in favor of a third-party claimant against a tort-feasor's insurer is not generally recognized absent statutory creation," La. R.S. 22:1220(B) "create[s] certain limited causes of action in favor of third-party claimants that derogate from established rules of insurance law." The *Theriot* court took pains to make clear that "[i]t is the relationship of the parties that gives rise to the implied covenant of good faith and fair dealing" between the insurer and insured. Inasmuch as *it is not the statute that creates the insured's cause of action against the insurer, the bases for an insured's cause of action for a breach of the implied covenant of good faith and fair dealing are not limited to the prohibited acts listed in La. R.S. 22:1220(B)*.

Id. at 427 (emphasis added). The Fifth Circuit found that the district court committed error by holding that an insurer's duty of good faith to its insured is limited to those items listed in 22:1220(B). The court then went on to examine whether any of the allegations made by the insured could constitute a breach of the insurer's duty of good faith to its insured. The Fifth Circuit recognized that the following two actions not listed in the statute could potentially be a breach of the duty of good faith depending upon the facts proved at trial:

- Settling litigation for policy limits without negotiating a full release for the insured; and
- Misrepresentation of policy terms and limits and nondisclosure of essential information about settlement.

Actual damages not required

Another controversy recently resolved by the Louisiana Supreme Court is whether a plaintiff must prove actual damages in order to recover the penalty of subsection (C) of the statute. In *Oubre v. Louisiana Citizens Fair Plan*, *supra*, the court examined the plain language of § 22:1973(C) which provides for a penalty award of "two time the damages sustained or five thousand dollars, whichever is greater." The court hearkened back to its earlier decision in *Sultana Corp. v. Jewelers Mut. Ins. Co.*, 860 So. 2d 1112 (La. 2003), in which it held that an insured is not required to prove that it suffered damages as a prerequisite for a discretionary award of penalties under § 22:1220. Thus, when damages are not proven, as was the case in the *Oubre* class action, the five thousand dollars acts as a ceiling on the penalty award. In *Oubre*, the Supreme Court affirmed the penalty of $5,000 per class member upon simple proof that the insurer failed to initiate loss adjustment within the required time period, resulting in a total award of over $92 million.

Mental anguish damages available

In *Wegener v. Lafayette Ins. Co.*, 2010-0810 (La. 3/15/11), 60 So. 3d 1220, the Louisiana Supreme Court held that mental anguish damages are available under La. R.S. 22:1973 and that they may be awarded regardless of the insurer's intent. The court supported its decision by reference to its prior opinion in *Manuel v. Louisiana Sheriff's Risk Management*, 95–0406 (La. 11/27/95), 664 So. 2d 81. Although *Manuel* did not deal with mental anguish damages, the court in *Manuel* explained that the duties imposed by La. R.S. 22:1973 are separate and distinct from any duties imposed by the contract of insurance. In further support of its decision that damages under La. R.S. 22:1973 do not necessarily follow rules applicable to damages for breach of contract, the court also cited with approval a recent case from the United States Fifth Circuit Court of Appeals interpreting Louisiana law, *Dickerson v. Lexington Ins. Co.*, 556 F.3d 290 (5th Cir. 2009).

Conclusion

Louisiana's law of bad faith has been codified in two statutes. The language of these statutes has been interpreted in case law, and the meaning behind various provisions

has been particularly clarified in the era of post-Katrina litigation. Insurers cannot blindly rely on the old "arbitrary, capricious or without probable cause" standard. That standard does not apply to claims for untimely initiation of loss adjustment, and apparently it will not protect insurers from penalties for errors in policy interpretation. The addition of Louisiana's second penalty statute (now 22:1973) codified the existing law regarding the duty of an insurer to deal with its insured in good faith, but did not supplant it. The statute did, however, extend new causes of actions to third-parties who were strangers to the insurance contract. As recently decided by the Louisiana Supreme Court, penalties under this statute may be awarded even without proof of actual damages, and damages may include mental anguish suffered as the result of an insurer's bad faith conduct.

While Louisiana's law of bad faith does not allow for unlimited punitive damages, there remain many potential traps for the insurer in the statutory language and jurisprudence.