IS THERE A CHINK IN THE STONEWALL?[1]

How To Sue The Insurance Company That Is Blocking Settlement

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The dictionary defines stonewall as behavior that is "uncooperative, obstructive, or evasive". Most lawyers are familiar with stonewalling. It most often arises in negotiations when one side refuses to budge, often even refusing to make an offer. When this occurs in a personal injury case, including a toxic tort case, it can be devastating because the injured party may not have the ability to continue through years of litigation to recover compensation. Often the injured party needs the recovery to meet medical bills, to be able to move away from the source of contamination or just to obtain some closure for what has been a traumatic personal tragedy. Defendants are also often benefitted by early resolution of a case, thus avoiding the turmoil caused by pending and inherently uncertain litigation including enduring discovery, the personal anguish associated with such litigation and the concern that a long drawn out trial may damage the defendant's reputation even if the verdict is ultimately for the defendant.

So why do so many lawyers report that settlements are less frequent and occur later in the

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litigation process than ever before? There may be a strategic advantage to the defense in being "uncooperative, obstructive, or evasive" when it comes to settlement discussions. Stonewalling may be even more attractive where there are many pre-trial steps that produce a total victory for the defendant including *Daubert* challenges and summary judgment motions. Nonetheless, many of these factors have been present for a long time and, until recently, lawyers reported most cases settled sooner and more frequently than is now occurring. There is some evidence that a principal cause of delay in resolution of a case is not the reluctance of the parties to settle, but the reluctance of the insurance company to authorize a good faith offer.

If this is true, only the insurance companies can provide evidence of the cause of the change in tactics. But, if this is true, it is not only plaintiffs who suffer. Defendants also suffer from protracted litigation, particularly where the defendant is potentially at risk for liability that exceeds the amount of its coverage or where, as often occurs in toxic tort cases, there is a collateral fight between the insured and insurer over whether there is any coverage at all. Since the defendant normally buys liability insurance to take care of legitimate claims it has every reason to be upset with the intransigence of the carrier where legitimate claims have been filed. It has been widely assumed that if the insurance company, for whatever reason, decides to stonewall, there is little that can be done by the defendant, short of a bad faith suit by the defendant after the case has ended, and nothing that can be done by the plaintiff.

What if the plaintiff were able to punish the insurance company for delaying the resolution of the case? If such punishment were sufficiently severe it could be a powerful weapon for the plaintiff and a strong counter-measure to insurance company stonewall tactics. There may be hope. Jay M. Feinman, Distinguished Professor of Law at Rutgers University

School of Law, Camden has been doing research on the subject of the legal consequences that may be imposed on an insurance company as a result of its failure to allow a good faith negotiation. His research has uncovered several interesting theories that focus on the liability insurance carrier, which normally controls the negotiation process, rather than the defendant.

UNFAIR CLAIMS SETTLEMENT PRACTICES ACT

Many states, including New Jersey, have adopted a Model Act addressing the issue of unfair claim settlement practices. New Jersey Statutes Annotated (N.J.S.A.) §17:29B-4; also see Colorado Revised Statutes § 10-3-1101 et seq; Montana Statutes, §33-18-201; New York Insurance Law (McKinney's Insurance Law) § 2601; 8 Vermont Statutes Annotated §4724. These laws generally provide that "no person may, with such frequency as to indicate a general business practice, do any of the following". Among the listed prohibited activities is "neglect to attempt in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear". Courts have tended to allow a private cause of action under these statutes for the injured party where the statute speaks in terms of "claimants" but to deny it where the statute uses the term "insured". New Jersey has rejected the principle that injured parties have a private right of action under this statute. *Pickett v. Lloyd's*, 131 N.J. 457, 621 A.2d 445 (1993).

Even if no private right of action exists, any party to a bad faith negotiation, where the insurance company is the principal cause of the problem, can report the insurance company misconduct to the local insurance commissioner or the State Attorney General. Given the growing interest by state and federal regulators in the business practices of major liability carriers, an insurance company faced with being reported to state authorities for violations of the

state's Unfair Claim Settlement Practices law may decide it is preferable to make a good faith effort to settle the claims. This preference will likely be heightened by the knowledge that the statutes require a showing that the settlement practice is engaged in with "such frequency as to indicate a general business practice", thus requiring a wide-ranging inquiry into the companies settlement tactics.

INJURED PARTY DIRECT ACTION AGAINST CARRIER FOR BREACH OF THE DUTY TO DEAL IN GOOD FAITH

A second theory posited by Professor Feinman is that the plaintiff can directly sue the insurance company for breach of the duty owed to the insured to bargain in good faith. The basis for this theory is that the plaintiff is the real beneficiary of the insurance policy since it is the plaintiff's injuries that are to be compensated. The problem is that with the exception of Florida (see e.g. *Thompson v. Commercial Union Insurance Company of New York*, 250 S.2d 259 (1971) and its progeny), the other jurisdictions that have addressed the issue have rejected the theory. However, several of those cases produced well-reasoned dissents or concurrences from well-respected jurists. See e.g. *Krupnick v Hartford Accident & Indemnity Co.*, 34 Cal. Rptr. 2d 39 (Ct.App. 1994) Justice Timlin *dissenting* 34 Cal. Rptr. at 63.

> Upon the involvement of an insured in an accident with a person who incurs injuries and/or property damage, resulting in that person making a claim against the insurer, a special relationship begins to exist between the claimant and the insurer at the time the claim is made creating a duty by the insurer and claimant to attempt to resolve the claim without unreasonable delay, in fairness and in good faith. This special relationship is not adversarial in

> nature but is one of openness, candor and understanding. It only becomes adversarial when one or both parties act unreasonably and unfairly toward the other during the attempt to settle, e.g., when there has been unreasonable delay or arbitrary refusal by the insurer to resolve the claim, particularly when the insured's liability for the accident and the claimant's injuries and losses are reasonably certain.

Id. Judge Timlin argued that there should be a "duty to deal honestly and in good faith during settlement negotiations with third-party claimants, and to attempt to come to a fair settlement within a reasonable amount of time after the insured's liability has become reasonably clear and the claimant's damages are reasonably ascertainable." *Id*. at 65. He applied the California test for determining the existence of a duty, and looked at the public policies involved:

> Insurance companies are in the business of insuring against risks, and presumably set their rates accordingly .... Allowing insurance companies to negligently refuse to pay, or delay paying, legitimate business obligations which were reasonably foreseeable after due consideration of the risks involved cannot be condoned (as does the majority) by characterizing third party actions against such insurers as an unwarranted expansion of tort liability, or by denying that such claimants can ever be the direct victims of insurers' negligent acts ....
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> Just as public policy mandates that parents undertake the support of their own children, that spouses undertake each other's support, that employers, regardless of fault, bear the cost, through worker's compensation insurance, of work-related injuries to employees, that tortfeasors bear the cost of injuries they have caused to others

> by wrongful conduct or nonconduct -- so that, at least in part, such burdens do not fall upon the general public -- so too public policy mandates that insurance companies undertake the burden of fairly and timely settling those claims as alleged here, when the insured's liability is reasonably clear and the claimants' damages are reasonably ascertainable and which they have contracted to cover, for a price, rather than allowing such costs and expenses encompassed by the claimed damages to fall on the shoulders of the injured claimants, and, in some cases, on the doctors and hospitals whose bills will go unpaid, the welfare systems to whom the injured parties may be forced to turn, and ultimately on the taxpaying public.

Id. at 85. See also, *Kranzush v. Badger State Mut. Cas. Co.*, 307 N.W.2d 256 (Wis. 1981)

Abrahamson, J. *concurring*:

> There are public policy reasons justifying the recognition of the insurer's duty of good faith to the third-party victim. Society has an interest in the just settlement of insurance claims, and this societal interest is substantially the same whether the injured party is the insured or a third-party.
> A third-party victim seeking recovery from the insurer is, as I see it, in substantially the same position as the first-party insured seeking benefits under a casualty policy. Both parties have been injured and both parties look to the insurance company for payment. When seeking payment under the policy both parties are in an adversarial relation with the insurance company. Both parties are generally in a relatively weaker bargaining position than the insurance company. Both parties can suffer as a result of the insurer's bad faith in settlement practices, and both parties may incur additional damage if payment of the claim is delayed. I recognize that the insured does buy the policy and pay the premiums and that the insurer and insured have obligations to each other under the contract which they do not have to the victim and which the victim does not have to them. Although the majority apparently takes the opposite view, I do not believe that the mutual

> obligations of the insurer and the insured are inconsistent with imposing on the insurer a duty to negotiate with the third-party victim in good faith.
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> I conclude that the interests of the insured and the third-party victim as to the settlement practices of the insurer are largely the same and that the public has an interest in the settlement practices of the insurer whether the insurer is dealing with the insured or with a third-party victim. Insurance holds an important place in our industrial society. Insurance is recognized by the insured, the victim, the legislature and the public as a system for compensating the third-party victim for injuries caused by another. Imposing a duty on the insurer to negotiate in good faith with the third-party victim is consistent with the intent of the first-party insured and of the legislature and with the popular concept of insurance which views the third-party victim as an intended third-party beneficiary of the insurance contract.

Id. 103 Wis.2d at 93-94, 307 N.W.2d at 274 - 275.

In New Jersey the courts have recognized that a duty owed to the insured extends to the injured party in certain circumstances. See *Carter Lincoln-Mercury, Inc. Leasing Division v. EMAR Group, Inc*., 135 N.J. 182, 202-03 (1994) finding an insurance broker liable to the person injured by the insured where the broker failed to discover and/or disclose to the insured that the insurer was not solvent and emphasizing that plaintiff was within an identifiable group of persons who would be proximately injured if the insurer were unable to pay a claim. *See also Samuel v. Doe*, 158 N.J. 134, 142, 727 A.2d 1016,1020 (1999)("If a settlement cannot be reached, Samuel may sue MTF directly. A liability insurance policy creates rights not only for the policy holder but as well for those to whom reparations will be made.").

Given the growing concern about the practices of liability insurance companies and the growing awareness that the uncompensated injured party becomes a liability for already over-stretched state and federal resources, the time is ripe for another effort to establish a plaintiff's right to directly sue an insurance carrier who fails to negotiate in good faith.

MALICIOUS DEFENSE

Professor Feinman's third theory is based on the principle that since there can be an abuse of process claim for a suit filed without substantial basis, there could also be an abusive defense claim based on the use of frivolous defenses and bad faith negotiations at which such defenses are urged. A few courts have embraced this principle using powerful reasoning that may provide other courts with the courage to act where the facts are sufficiently egregious. See *Aranson v. Schroeder*, 671 A.2d 1023 (N.H. 1995) holding:

> When a defense is commenced maliciously or is based upon false evidence and perjury or is raised for an improper purpose, the litigant is not made whole if the only remedy is reimbursement of counsel fees. It follows that upon proving malicious defense, the aggrieved party is entitled to the same damages as are recoverable in a malicious prosecution claim.

Id. 671 A.2d at 1028. The Court described the criteria for malicious defense:

> One who takes active part in initiation, continuation, or procurement of defense of civil proceeding is subject to liability for all harm proximately caused, including reasonable attorney fees, if he or she acts:
> (1) without probable cause;
> (2) with knowledge or notice of lack of merit in such actions;
> (3) primarily for purpose other than securing the proper adjudication of the claim and defense thereto, such as to harass,

> annoy or injure, to cause unnecessary delay or needless increase in the cost of litigation;
> (4) previous proceedings were terminated in favor of party bringing malicious defense action; and
> (5) injury or damage is sustained.

Id. at 1028-29.

More recently these concepts were also expressed by the Arizona Appellate Court in *Crackel v. Allstate*, 92 P.3d 882 (2004) where it held an abuse of process claim would lie against Allstate but "a plaintiff must show that the defendant's improper purpose was the primary motivation for its actions, not merely an incidental motivation" and "a claimant must establish that the defendant used a court process in a fashion inconsistent with legitimate litigation goals." *Id*. 92 P.3d at 889. In that case the Court found it was sufficient that plaintiff alleged that Allstate used the prospect of sustained and expensive litigation as a "club" in an attempt to coerce them, and other similarly situated claimants, to surrender those causes of action that sought only modest damages and that Allstate had adopted written policies governing certain claims directing its adjusters and attorneys to handle certain kinds of claims in such a way that it would not be financially feasible for claimants to pursue litigation. In addition, Allstate also failed to participate in good faith in a settlement conference, for which it was sanctioned because it had (1) intentionally refused to abide by the local rule requiring distribution of pretrial memoranda to opposing counsel in preparation for the conference, (2) told the trial court that nothing the court could say would affect Allstate's negotiating position, and (3) misrepresented the conclusions of Allstate's expert on whether it had been reasonable for the plaintiff to seek medical attention after the accident. The court was struck by the fact that Allstate had made an offer of judgment of $101, even though it conceded that it's insured was 100 percent negligent

and the plaintiffs' medical expenses, which is all they initially sought, were $1,600. As the trial court said, Allstate's "actions are part of a policy regime designed to harass, intimidate and inflict excessive expense on plaintiffs." *Id*. 92 P.3d at 890.

This conduct by Allstate should come as no surprise to attorneys for injured parties in New Jersey where Allstate has loosed a virtual reign of terror on claimants, particularly medical claimants under PIP. Nor are these isolated examples of Allstate's practices. *See False Promises-Allstate, McKinsey and the Zero Sum Gain*, David J. Bernardinelli, The New Mexico Trial Lawyer (July/August 2005) detailing Allstate's tactics, as described in previously secret documents, to enhance its profits by restricting its payment of legitimate claims.

CONCLUSION

Stonewalling is not a new tactic. Its impact on the orderly resolution of disputes is well-recognized and particularly damaging when both plaintiff and defendant would like to bargain in good faith and the defendant's insurance carrier makes that impossible. It may be many years before the theories discussed here and explored by Professor Feinman and others[3] are widely adopted. However, the current climate in which insurance companies are increasingly using the stonewalling tactic and are increasingly under careful scrutiny for many other practices of

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[3] See Francis J. Mootz III, *The Sounds Of Silence: Waiting For Courts To Acknowledge That Public Policy Justifies Awarding Damages To Third-Party Claimants When Liability Insurers Deal With Them In Bad Faith*, 2 Nev. L. J. 443 (2002) and *Holding Liability Insurers Accountable For Bad Faith Litigation Tactics With The Tort Of Abuse Of Process*, 9 Conn. Ins. L.J. 467 (2002/2003).

questionable legality, make this the best time for plaintiffs to begin to test these theories in the real world where courts may give them more than a cursory examination.