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Insurance Bad Faith

Extra-contractual Damages Against Insurers For Failure To Settle In Connecticut

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A commentary article reprinted from the July 13, 2015 issue of Mealey's Litigation Report: Insurance Bad Faith

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Commentary

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Litigation in Connecticut is as risky as any state, especially in professional liability cases. Exposure is often substantial, non-economic damages are not capped, and appellate courts rarely reduce verdicts. When claims potentially exceed policy limits, insureds often retain personal counsel to demand payment because of the exposure. Plaintiffs rarely pursue personal assets of policy holders but routinely demand policy limits knowing that insurers are reluctant to pay them and that a verdict in excess of policy limits may entitle plaintiffs to extra-contractual damages. Further, insureds may ally themselves with plaintiff's counsel against their insurer because of concern about personal liability.

Bad faith law varies significantly by state, thereby requiring analysis of individual states. In Connecticut, the law is not clear, making evaluations especially difficult. Bad faith traditionally requires (1) deprivation of an intended, expected benefit to the insured plus (2) denial of that benefit in "bad faith." The classic case of bad faith is failure to settle a clear liability case with policy limits significantly less than damages. Many cases define "bad faith" as intentional wrong doing, i.e., malice or intent to defraud. However, in practice, plaintiffs counsel assert that policies do give insureds the implied right to protection from adverse verdicts above policy limits. They also claim that malice is not a pre-requisite and that it is sufficient to show negligence or failure to reasonably evaluate a case or putting the insurer's interests ahead of the insured's interests. Indeed, as demonstrated below, Connecticut's definition of a policy holder's rights is fuzzy. Some cases refer to an explicit right in the policy. Other cases refer to "expected benefits." Some cases refer to malice while others talk about an insurer acting reasonably in asserting its rights, while others refer to an insurer placing its rights above the insured. Some cases explain bad faith in ways which seem likely to generate more heat and debate than light. Connecticut also recognizes claims for negligent failure to settle as a theory of liability separate from bad faith. A defense to negligence actions, not commonly cited in the cases described below, however, is the "economic loss" rule which precludes negligence claim damages are solely economic. Another theory of liability is breach of a fiduciary obligation to protect the insured. Meanwhile, an Arizona case cited in Connecticut, the court referred to a balancing of the rights of the insured and the insurer.

The purpose of this article is to review recent Supreme Court and trial (Superior) court decisions (some involving failure to settle and some involving other aspects of bad faith) as to whether failure to settle a defensible claim within policy limits, despite potential excess liability, constitutes bad faith. If not, are there other theories of liability justifying extra-contractual damages? It is not intended to constitute a thorough analysis of each theory of liability which, of course, is case specific in any event.

Connecticut Unfair Insurance Practice Act, "CUIPA," CGS § 38a-815 et seq.

Connecticut's Unfair Insurance Practice Statute subjects insurers to regulatory sanction for a pattern and

practice of unfair claims practices. It does not give rise to a private cause of action for a single "unfair" claims practice. However, individual claims cite the statute insofar as it provides examples of statutorily defined unfair insurance practices. Thus, Sec. 38-816(6) states:

> Committing or performing *with such frequency* as to indicate a general business practice any of the following: . . . (f) not attempting in good faith to effectuate *prompt, fair and equitable settlements of claims in which liability has become reasonably* clear; (g) compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds; . . . (k) making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration; . . . (m) failing to promptly settle claims where liability has become *reasonably* clear under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage; (n) *failing to promptly provide a reasonable explanation of* the basis . . . *for denial of a claim or for the offer of a compromise settlement;* . . .

Supreme Court Decisions

Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 308 Conn. 760 (2013) raises the question as to whether failure to settle a claim which could exceed policy limits deprives the insured of an "express benefit" under the policy. Plaintiff claimed that the insurer acted in bad faith for failing to conduct a discretionary investigation of claims. The Supreme Court held that there was no bad faith based upon the insurer's failure to investigate because the policy provided that the decision of whether and how to investigate lies *exclusively* with the insurer. The Court noted that bad faith required denial of the receipt of an "express benefit" under the policy, citing *Renaissance Management Co. v. Connecticut Housing Finance Auth.*, *281 Conn. 227, 240, 915 A.2d 290 (2007)*:

> "[I]t is axiomatic that the . . . duty of good faith and fair dealing is a covenant implied into a contract or a contractual relationship. . . . In other words, *every contract carries an implied duty requiring that neither party do anything that will injure the right of the other to receive the benefits of the agreement.* . . . The covenant of good faith and fair dealing presupposes that the terms and purpose of the contract are agreed upon by the parties and that what is in dispute is a party's discretionary application or interpretation of a contract term. . . .
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> "To constitute a breach of [the implied covenant of good faith and fair dealing], *the acts by which a defendant allegedly impedes the plaintiff's right to receive benefits that he or she reasonably expected to receive under the contract must have been taken in bad faith.* . . .

The Supreme Court said "*violations of express duties are necessary to maintain a bad faith cause of action,*" citing *PSE Consulting, Inc. v. F Mercede & Sons, Inc.*, 267 Conn. 279 (2004). In that case, the performance bond contained *mandatory* terms obligating the surety to "send an answer to [the principal] within 45 days after receiving formal notice of the [principal's] claim against the bond," and to "identify what part of the claim it had determined to be undisputed, as well as to provide the basis for challenging any disputed amounts." The Court contrasted this with the "discretionary investigation" alleged by the plaintiffs in the present case, concluding that a bad faith cause of action could not be based solely on an allegedly inadequate *discretionary* investigation. The Court added that the claimed benefit had to have a reasonable basis in the contract, stating: "Our conclusion that bad faith is not actionable *apart from a wrongful denial of a benefit under the policy* finds support in both authoritative treatises and cases from other jurisdictions."

The Court also defined "bad faith" as requiring proof of malice but did not reach that issue, stating:

> Bad faith in general implies *both actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister*

> *motive. . . . Bad faith means more than mere negligence; it involves a dishonest purpose."* (Citations omitted; internal quotation marks omitted.) *DeLa Concha of Hartford, Inc. v. Aetna Life Ins. Co*, 269 Conn. 424, 432-33 (2004).

Renaissance Mgmt Co. v. Conn. Hous. Fin. Auth, 281 Conn. 227 (2007), involved alleged failure to permit pre-payment of a mortgage. The Supreme Court found no denial of "*benefits"* that the insured *"reasonably expected to receive under the contract," citing De La Concha of Hartford, Inc.* v. *Aetna Life Ins. Co.*, 269 Conn. 424 (2004). *De La Concha of Hartford, Inc. supra*, was a landlord-tenant dispute. Plaintiff alleged that its landlord, Aetna, committed bad faith breach of contract in failing to meet its obligation to promote the Civic Center and to make reasonable efforts to maintain the occupancy rate at an acceptable level. Plaintiff also claimed that once Aetna had decided to sell the Civic Center, it engaged in a "scheme" or course of conduct to "starve out" the plaintiff and other tenants so as to make the Civic Center more appealing to potential purchasers who, without tenants, would have greater flexibility. The trial court found that the defendant "acted *reasonably*" to cut its losses arising from the operation of the Civic Center in light of "dramatically changed circumstances, namely, departure of the Hartford hockey team, the expansion of shopping malls in the suburbs and the deteriorating economic situation in downtown Hartford." Explaining the "expected benefit," the Court said:

> "To constitute a breach of [the implied covenant of good faith and fair dealing], the acts by which a defendant allegedly *impedes the plaintiff's right to receive benefits that he or she reasonably expected to receive under the contract must have been taken in bad faith*." *Alexandru v. Strong*, 81 Conn. App. 68, 80-81, cert. denied, 268 Conn. 906 (2004), citing *Gupta* v. *New Britain General Hosp.*, 239 Conn. 574, 598 (1996).

The Court defined bad faith as follows:

> "Bad faith in general implies *both actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive. . . .* Bad faith means more than mere negligence; it involves a dishonest purpose." (Citation omitted; internal quotation marks omitted.) *Habetz* v. *Condon*, 224 Conn. 231, 237 (1992).

Superior Court Decisions

Superior (trial) Court decisions mostly focus upon challenges to pleadings, i.e., motions to strike because of failure to specifically allege "bad faith." Some courts require express allegations of bad faith, while other cases permit bad faith to be inferred from allegations. Some address bad faith but others refer to related theories of liability.

Bad Faith

In *Chestnut Inv, LLC v. Nautilus Ins Co., 2012 Conn. Super. Lexis 95 (2012)*, the Court held that bad faith required a showing of *malice.* Citing *Renaissance Management Co. v. Connecticut Hsg Finance Auth*, *281 Conn. 227, 240 (2007)*, the Court said:

> "[B]ad faith . . . generally [implies] a *design to mislead or to deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation not prompted by an honest mistake as to one's rights or duties."* (Internal quotation marks omitted.) *Buckman v. People Express, Inc.*, 205 Conn. 166, 171, 530 A.2d 596 (1987). "[B]ad faith is not simply bad judgment or negligence, but rather *it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity . . . it contemplates a state of mind affirmatively operating with furtive design or ill will." (Internal quotation marks omitted.) Id. "Bad faith means more than mere negligence; it involves a dishonest purpose." (Internal quotation marks omitted.)*

The Court found that the Complaint alleged something more than "breach" but less than "malice," noting that "reckless disregard" was not sufficient, stating:

> The specific conduct alleged does not imply "a design to mislead or to deceive another or a neglect or refusal to fulfill some duty or some contractual obligation not prompted by an honest mistake as to one's rights or

> duties." . . . *Buckman v. People Express, Inc., supra, 205 Conn. 171*. Instead, the specific conduct alleged merely shows that Nautilus gave reasons for denying its claim. Apart from the prior trial court decision, the plaintiff does not allege any other facts that show why the reasons for denial were in bad faith, nor can any bad faith be inferred from the reasons alone.

The Court also rejected a "wrongful failure to settle" claim under CUIPA, CGS § 38a-815 et seq. noting that the act required a "pattern" of wrongful failure to settle claims.

Fischer v. Fid. Nat'l Title Ins. Co., 2014 Conn. Super. LEXIS 3032 (2014), which involved denial of a title insurance claim, required a claim of malice to support a bad faith claim:

> "The elements of a cause of action alleging breach of the implied duty of good faith and fair dealing are as follows: (1) the plaintiff and the defendant were parties to a contract under which the plaintiff reasonably expected to receive certain benefits; (2) that the defendant engaged in conduct that injured the plaintiff's right to receive some or all of those benefits; and (3) that when committing the acts by which it injured the plaintiff's right to receive benefits he reasonably expected to receive under the contract, the defendant was acting in bad faith." (Internal quotation marks omitted.) *Perez v. State Farm Fire & Cas. Co., 2014 Conn. Super. LEXIS 1798 (Aug 6, 2014)* . . .
>
> *"Bad faith in general implies both actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive . . . Bad faith means more than mere negligence; it involves a dishonest purpose."* (Internal quotation marks omitted.) *Capstone Building Corp. v. American Motorists Ins. Co.*, 308 Conn. 760, 795, 67 A.3d 961 (2013).

In *Kolb v. Sage Custom Homes, LLC, 2014 Conn. Super. LEXIS 3042 (2014)*, plaintiffs alleged that defendants acted in bad faith by failing to provide a new home construction contractor's contract pursuant to the Home Improvement Act CGS § 20-417. Striking the Complaint, the Court said:

> *. . . Bad faith in general implies both actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive. Bad faith means more than mere negligence; it involves a dishonest purpose."* (Internal quotation marks omitted.) *Capstone Bldg Corp. v. American Motorists Ins Co., 308 Conn. 760, 794-95 (2013).*

In *Merrimack Mut. Fire Ins. Co. v. 4890 Main St., LLC, 2014 Conn. Super. LEXIS 3073 (2014)*, the Court found that an insured engaged in fraud where it "violated, good faith and fair dealing by his fraudulent conduct designed to deceive the plaintiff by filing a claim and accepting coverage of lost rental" which the defendant was receiving from his tenant. The defendant "concealed his double recovery until subrogation claim brought against his tenant brought out the defendants' deception." He "dishonestly and intentionally deceived and misrepresented his claimed loss of rental income to his own insurance adjuster, the plaintiff, Merrimack, and his tenant, the Association." The Court said:

> ". . . Bad faith in general implies both actual or constructive fraud, or he designed to deceive another, or neglect a refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive . . . Bad faith means more than mere negligence; it involves a dishonest purpose . . ." (Internal quotation marks omitted.) *TD Bank, N.A. v. J&M Holdings, LLC*, 143 Conn. App. 340, 348, 70 A3d. 156 (2013).

In *Nationwide Mut. Fire Ins. Co. v. Hermann, 2014 Conn. Super. LEXIS 2100 (2014)*, the Court struck claims as conclusory noting that proof of malice was required:

> *Bad faith in general implies both actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some*

> *duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive* . . . Bad faith means more than mere negligence; it involves a dishonest purpose." (Citations omitted; internal quotation marks omitted.) *Rafalko v. Univ of New Haven*, *129 Conn.App. 44, 51 (2011). Bad faith claims must be alleged in terms of wanton and malicious injury and evil intent. Id.*, citing *Grant v. Colonial Penn Ins. Co.*, *16 Conn. L. Rptr. 49, 1996 Conn. Super. LEXIS* 124 (Jan 16, 1996, Hauser, J). Mere allegations of bad faith are insufficient to support a cause of action on that theory. *McCrea v. Louis Dreyfus Corp.*, 12 Conn. L. Rptr. 493, 1994 Conn. Super. LEXIS 2468].

Katz v. Hartford Fin. Servs. Group, Inc. 2012 Conn. Super. LEXIS 1269 (2012), also required a showing of malice to support a claim of bad faith failure to settle. The Court said:

> Bad faith in general implies both actual or constructive fraud, or a design to mislead or deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive . . . Bad faith means more than mere negligence; it involves a dishonest purpose." (Citations omitted; internal quotation marks omitted.) *De La Concha of Hartford v. Aetna Life Ins. Co.*, *269 Conn. 424, 433, 849 A.2d 382 (2004).* "[B]ad faith is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity . . . [I]t contemplates a state of mind affirmatively operating with furtive design or ill will." (Internal quotation marks omitted.) *Hutchinson v. Farm Family Cas Ins. Co.*, *273 Conn. 33, 42 n.4, (2005).*

The case presumably could have, but did not include, a claim of negligent failure to settle.

Inferring Bad Faith from Allegations

In Perkins v. Hermitage Ins. Co. 2012 Conn. Super. LEXIS 554 (2012), the Court permitted a Complaint despite conclusory allegations where plaintiff alleged breach of contract and that the breach resulted from a dishonest purpose even though plaintiffs had not alleged "specifically" that the defendant had an "intent to mislead or deceive or defraud" its insureds. However, the Court found that liability was "clear and probable." Thus, the Court said:

> Looking to the allegations for bad faith, the plaintiffs allege that the defendant failed to provide a defense to its insured, 302 Corporation; failed to indemnify its insured; failed to conduct a full and fair investigation of the complaint against its insured; and refused to satisfy the judgment against its insured. Those allegations are all included in the plaintiffs' counts for breach of contract and are incorporated in the bad faith claims. The plaintiffs then allege that the defendant regularly engages in bad faith by wrongly refusing to honor claims presented against it and fail to indemnify and defend its insureds as a regular business practice. These alleged practices force the insureds to pay legal fees; causes them emotional distress; and causes them to incur judgments against them. The plaintiffs allege this course of conduct was done with a "dishonest purpose" when the defendant knew or should have known based on the information the defendant had, that its insured's liability was clear and probable." *While the plaintiffs have not specifically alleged that the defendant had an intent to mislead or deceive or defraud its insureds, they have alleged a "dishonest purpose" and other additional allegations, including specific insurance policy provisions, sufficient to imply bad faith.*

Breach of Fiduciary Duty and Balancing of Rights

In *Wood v. Club, 2013 Conn. Super. LEXIS 1985 (2013)*, plaintiff alleged that defendant insurers rejected a settlement and proceeded to trial putting its personal interest ahead of the insured's which wanted the case settled. Plaintiff alleged that this constituted bad faith and "breach of fiduciary duty." The Court rejected the claims finding lack of malice and noting that time limited demands were arbitrary and premature. It is not clear how the Court would have ruled had the demands

been timely offers of compromise after a reasonable opportunity for discovery. In contrast to cases which refer to a "deprivation" of a contractual right, the Court discussed a "balancing of interests," stating:

> . . . the breach of fiduciary duty claim should be considered independent of any of Judge Adams' determinations contained in the court's memorandum of decision dated May 9, 2013. The plaintiff had not yet pleaded his breach of fiduciary duty claim at that stage in the proceedings, and, thus, that claim was not before the court. Breach of fiduciary duty is a cause of action that is distinct to claims of unfair settlement practices in violation CUIPA/CUTPA or breach of the covenant of good faith and fair dealing that is implied in contract negotiations. "A fiduciary or confidential relationship is characterized by a unique degree of trust and confidence between the parties, one of whom has superior knowledge, skill or expertise and is under a duty to represent the interests of the other. The superior position of the fiduciary or dominant party affords him great opportunity for abuse of the confidence reposed in him." (Citations omitted.) *Dunham v. Dunham*, 204 Conn. 303, 322, 528 A.2d 1123 (1987), overruled on other grounds by, *Santopietro v. New Haven*, 239 Conn. 207, 213, 682 A.2d 106 (1996).
>
> "To successfully allege a breach of fiduciary duty, the plaintiff must allege facts establishing two separate elements: (1) the existence of a fiduciary duty, and (2) a breach of that duty, specifically, a breach of the duty of loyalty and honesty. If allegations establishing either element are absent, the claim for breach of fiduciary duty will not survive a motion to strike." *Seven Bridges Foundation v. Wilson Agency, Inc.*, Superior Court, judicial district of Stamford-Norwalk at Stamford, Docket CV 11 6009707 (March 2, 2012, Tobin, J.) (53 Conn. L. Rptr. 584, 2012 Conn. Super. LEXIS 564). The application of traditional principles of fiduciary duty have not been expressly limited to cases involving only fraud, self-dealing or conflict of interest, though those types of cases are the most common. See *Murphy v. Wakelee*, 247 Conn. 396, 400, 721 A.2d 1181 (1998). "[T]o survive a motion to strike a count framed as a breach of fiduciary duty, a pleader must allege facts which implicate the morality of [the defendant's] conduct." *J.S.T. Development Corp. v. Vitrano*, 2004 Conn. Super. LEXIS 2136). "Fiduciaries have an obligation to disclose all conflicts of interest to their principals." *State v. Acordia, Inc.*, 2010 Conn. Super. LEXIS 800) (involving an insurance agent fiduciary). The allegations of count six do not amount to a legally sufficient breach of fiduciary duty claim. With respect to the second element that must be pleaded, i.e., a breach of the duty of loyalty and honesty, no dishonesty or disloyalty on the part of the insurer defendants, at least in their interactions with their insureds, is either expressly alleged or can reasonably be inferred. Count six is devoid of any allegations to suggest that the insureds did not acquiesce in, or otherwise approve of, the insurer defendants' decisions to reject settlement offers. Essentially, count six alleges that the insurer defendants merely decided to forgo a settlement and opt to proceed to a trial. See e.g. *Carford v. Empire Fire & Marine Ins Co.*, *2012 Conn. Super. LEXIS 2147 (Aug 12, 2012*, Tyma, J). Nothing in the alleged facts gives rise to an implication that the insurer defendants acted in a manner that was disloyal or dishonest to their insured.

The Court also noted that the insurer reasonably believed that a verdict would not exceed policy limits, stating:

> *While it is axiomatic that jury verdicts can surprise parties and that juries can deliver verdicts substantially above or below the evaluations of parties or arbitrators, thereby creating an element of financial risk in going to trial, the defendant's insurer's rejection of plaintiff's offer of compromise at $30,000, and the arbitrator's decision at $50,849 in and of itself does not evidence bad faith or breach of fiduciary duty. Indeed the plaintiff's valuation and the arbitrator's decision may well have bolstered a view of the insurer defendants that the*

> *likelihood of a verdict in excess of the policy limits was minimal. In any event, more than rejection of a comparatively small offer of settlement is necessary to state a claim for breach of fiduciary duty and the sixth count is lacking in those essential allegations.*

Hartford Accident & Indem. Co. v. Aetna Cas. & Sur. Co. 164 Ariz. 286; 792 P.2d 749 (1990), an Arizona case cited in *General Star Indem. Co. v. Travelers Indeminity Co. 2013 Conn. Super. LEXIS 808 (2013)*, also discussed a balancing of rights in the context of holding that an excess carrier could to be subrogated to the rights of the insured. Thus the Court said:

> It is settled law in Arizona, based on a covenant of good faith and fair dealing, that an insurance company owes its insured a duty of good faith in deciding whether to accept or reject settlement offers. *Arizona Prop. & Cas. Ins. Guar. Fund v. Helme*, *153 Ariz. 129, 137, 735 P.2d 451, 459 (1987); City of Glendale v. Farmers Ins. Exchange*, *126 Ariz. 118, 120, 613 P.2d 278, 280 (1980); Farmers Ins. Exchange v. Henderson*, *82 Ariz. 335, 338-39, 313 P.2d 404, 406 (1957). In the third party context, this duty of good faith requires an insurer to give equal consideration to the protection of the insured's as well as its own interests. Henderson, 82 Ariz. at 338, 313 P.2d at 406. If an insurance company fails to settle, and does so in bad faith, it is liable to the insured for the full amount of the judgment. Id . at 341, 313 P.2d at 408. This rule is recognized, in part, because the insurer exercises control over the litigation.*

Negligent Failure to Settle

In *Akl v. Trumbull Ins. Co., 2014 Conn. Super. LEXIS 563 (2014)*, plaintiff alleged negligence *or* bad faith in failing to settle a car accident case plus failure to provide a reasonable explanation for its decision to not settle. Plaintiff further alleged that defendant "intentionally made a minimal offer to settle the plaintiff's case, with full knowledge that similar cases have a value well in excess of the amount offered, in violation of Connecticut General Statutes § 38a-816; [and] engaged in a deliberate policy of inaction, uncooperation, delay, and/or avoidance in connection with the plaintiff's claim under the policy." Count Two alleged "bad faith." Count Three alleged negligent failure to settle. The Court struck the bad faith claim because of conclusory allegations not supported by specific facts showing evil intent or malevolence, stating:

> "To constitute a breach of [the implied covenant] the acts by which a defendant allegedly impedes the plaintiff's right to receive benefits that he or she reasonably expected to receive under the contract must have been taken in bad faith." Id. Bad faith implies "a design to mislead or to deceive another . . . [B]ad faith is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity . . . it contemplates a state of mind affirmatively operating with furtive design or ill will." *Buckman v. People's Express, Inc., 205 Conn. 166, 171 (1987); DeLa Concha of Hartford, Inc. v. Aetna Life Ins. Co, 269 Conn. 424, 433 (2004).* Proof of bad faith in the insurance coverage context requires proof that the insurer has denied coverage without a reasonable basis and has acted with a "dishonest purpose." *De La Concha of Hartford, Inc., supra, at 433.* The appellate courts of this state have not addressed the precise issue here: where an insurer denies or limits coverage under an insurance policy, what allegations are required to allege bad faith, as opposed to breach of contract. However, a majority of trial courts have held that "plaintiffs must plead facts that go beyond a simple breach of contract claim and enter into a realm of tortious conduct which is motivated by a dishonest or sinister purpose." *Ferriolo v. Nationwide Insurance, 1998 Ct. Sup. 2563, 1998 Conn. Super. LEXIS 641 (March 11, 1998, Hartmere, J.). See also Chestnut Investment, LLC v. Nautilus Ins. Co., 2012 Conn. Super. LEXIS 95, 2012 WL 310761 at *4 (Jan. 6,2012, Wilson, J.); McCullough v. Encompass Indem. Co., 2009 Conn. Super. LEXIS 3256, 2009 WL 5342506 (Dec. 10, 2009, Swienton, J.)* (alleged misrepresentations of the amount of coverage, applicable policy provisions, change in position of the amount due and payable, failure to act with

> reasonable promptness and failure to timely and accurately handle claim are simply claims that insurer did not property handle claim for benefits under policy not evidence of intentionally dishonest or morally oblique or sinister conduct); *Crespan v. State Farm Mut Automobile Ins. Co., 2006 Ct. Sup. 994, 2006 Conn. Super. LEXIS 139 (Jan. 13, 2006, Pickard, J.); Bernard v. Buendia , 2005 Ct. Sup. 11369, 2005 Conn. Super. LEXIS 1844 (July 20, 2005, Doherty, J.)* (In order to make a bad faith claim the plaintiff must allege that the defendant did more than simply deny the plaintiff's claim for benefits); *O&G Industries, Inc. v. Travelers Property Cas Corp, 2001 Ct. Sup. 12601, 2001 Conn. Super. LEXIS 2568 (Sep. 7, 2001, Cremins, J.)* (plaintiff's mere legal conclusion that the failure to defend and indemnify amounts to a violation of the duty of good faith and fair dealing was insufficient and did not properly state a claim of bad faith); *Grant v. Colonial Penn Ins Co, 1996 Ct. Sup. 482, (Jan.16, 1996, Hauser, J.) [16 Conn. L. Rptr. 49, 1996 Conn. Super. LEXIS 124]* (Bad faith claim must be alleged in terms of wanton and malicious injury and evil intent).

The Court also struck the negligence claim because of the economic loss rules which precludes negligence claims where the only damages are economic, as opposed to damages for personal injury or property damage, stating:

> "The economic loss doctrine, a judicially created principle, prohibits recovery in tort where the relationship between the parties is contractual in nature and the only losses alleged are purely economic." *First American Title Ins. Co. v. 273 Water Street, LLC*, 2010 Conn. Super. LEXIS 3449 (Aug. 30, 2010, Peck, J). The Connecticut Supreme Court first applied the economic loss doctrine in *Flagg Energy Dev. Corp. v. GMC, Allison Gas Turbine Div.*, 244 Conn. 126 (1988). In 2013 the Supreme Court released its decision in *Ulbrich v. Groth*, 310 Conn. 375 (2013), clarifying that its decision in *Flagg Energy Development Corp.* was not limited only to sales covered by Article 2 of the UCC. *Id.* at 405. The court in *First American Title Ins. Co., supra*, explained the economic loss doctrine as it applies in the insurance context:
>
> The most persuasive argument in support of extending the economic loss doctrine lies in the Superior Court cases analyzing torts arising out of insurance agreements and considering the public policy associated with such an extension. *"Insurance companies . . . in order to be able to make a reasonable profit have to rationally allocate risks." Without the ability to limit risk within liability policies, insurers could not operate, or premiums would be exorbitant. Insurance industry depends on its right to allocate risk and limit potential liability by contract terms. First American Title Ins. Co., supra, at 6.*

Carford v. Empire Fire & Marine Ins. Co. 2012 Conn. Super. LEXIS 2147 (2012), also alleged "negligent failure to settle" within policy limits after an excess verdict. Plaintiff alleged that the defendant negligently wanted to save something off its policy rather than protect the insured from excess liability. The Court said that "negligent failure to settle" and failure to act in "good faith," were different. Absent "negligence," "bad faith" does not exist but absent "bad faith," negligence alone would be sufficient to impose liability. It also acknowledged that there was a blurred line in terms of describing the claim as contract or tort. Insofar as one of the essential purposes of law is to provide guidance, especially in business affairs, this opinion shows the lack of guidance and lack of clarity about these important issues. The Court said:

> Connecticut has long recognized a cause of action for negligent failure to settle a claim. "In situations analogous to that presented by this case courts have applied varying standards by which to determine whether or not an insurer is liable to an insured for failing to settle a claim. These may be generally summarized as a requirement of good faith and honest judgment on the part of the insurer or one that the insurer should use that care and diligence which a person of ordinary prudence would exercise in the

management of his own business . . . The trial court concluded that the defendant had not failed to meet either of these tests. If it was correct as to the more exacting of the two, that is, the requirement of reasonable care, there is no need now for us to decide whether one test or the other should be adopted in this jurisdiction as determinative of the obligations of an insurer in such a case." (Internal citations omitted.) *Hoyt v. Factory Mutual Liability Ins. Co., 120 Conn. 156, 159 (1935). See also Capitol Fuel Co, Inc. v. New York Casualty Co., 16 Conn. Sup. 155, 158 (1949)* ("From all the pertinent literature enjoyed by the court, it is concluded that the trend of judicial and text opinion favors the more just and modern theory of holding an insurer accountable for want of due care in handling a case against its assured"); *Bourget v. Gov't Employees Ins Co., 456 F.2d 282, 285 (2nd Cir. 1972); Windmill Distributing Co v. Hartford Fire Ins. Co., 742 F. Sup.2d 247, 263 (D.Conn. 2010).* "The basis for judicial imposition on liability insurers of a duty to exercise good faith or due care with respect to opportunities to settle within the policy limits is that the company has exclusive control over the decision concerning settlement within policy coverage, and company and insured often have conflicting interests as to whether settlement should be made . . . Whether one considers the insured's claim to sound in tort, as most of the cases have . . . or as based on an expansive reading of the contractual obligation to protect up to the agreed limits . . . what gives rise to the duty and measures its extent is the conflict between the insurer's interest to pay less than the policy limits and the insured's interest not to suffer liability for any judgment exceeding them." (Citations omitted; internal quotation marks omitted.) *Bourget v. GEICO., supra, 456 F.2d 285.*

In *Hoyt*, the plaintiff brought an action against the defendant, her own insurance company, "to recover [the amount of the verdict in] excess [of her policy] upon the ground that the defendant was guilty of a breach of duty in not making a settlement with the [the injured party] instead of proceeding with the trial." *Hoyt v. Factory Mutual Liability Ins. Co.*, *supra*, 120 Conn. 156. In the trial of underlying matter, the jury found that plaintiff was responsible for the personal injuries sustained by a child and awarded damages that exceeded the plaintiff's policy limits. *Id.*, 157. In the subsequent trial court action by the plaintiff against the defendant seeking to recover the excess amount, the court rendered judgment for the defendant. *Id*. On appeal, our Supreme Court reviewed the facts in the record concerning the defendant's potential liability for the claim, the amount of damages and the settlement process and concluded that "[t]he record does not present a situation where we can say as matter of law that the defendant failed to use *that degree of care and prudence which a person in such a situation as that in which it was placed would have used in the management of a business in which no one other than himself had an interest.* The conclusion of the trial court that the defendant was not negligent must stand and this disposes of the case."

The opinion noted that when plaintiff made a time limited demand, the defendant had not had sufficient time to investigate the claim. When an offer to settle was made, plaintiff rejected it as untimely. The Court concluded that the defendant was not negligent in rejecting the settlement demand at the time it was made. It is not clear how the Court would have evaluated such a demand later in the litigation. The Court also did not address the economic damages rule, that a claim for economic damages only is based in contract, not tort. *Flagg Energy Dev. Corp. v. GMC, Allison Gas Turbine Div.*, 244 Conn. 126 (1988).

In *Perez v. State Farm Fire & Cas. Co., 2014 Conn. Super. LEXIS 1798 (2014)*, the insured claimed that its property was not sufficiently restored after damage covered by the policy. Plaintiff alleged bad faith violation of the insurer's obligations under the contract and negligence. The Court held that even though recovery in tort would arise by virtue of duties *other* than those arising under the contract, a plaintiff could pursue either remedy or both. Thus, the Court said:

"An action in contract is for the breach of a duty arising out of a contract; an action in

tort is for a breach of a duty imposed by law." (Internal quotation marks omitted.) *Gazo v. Stamford*, 255 Conn. 245, 263, 765 A.2d 505 (2000). "Unless a particular conflict between the rules of contract and tort requires otherwise, a plaintiff may choose to proceed in contract, tort, or both." (Footnote omitted.) *Stowe v. Smith* , 184 Conn. 194, 199, 441 A.2d 81 (1981). "[N]egligence may be the outgrowth of precedent contractual relationship, but . . . it may also arise in situations where there is no thought of any such underlying relationship . . ." *Dean v. Hershowitz*, *119 Conn. 398, 408, 177 A. 262 (1935).* "Where there is a precedent relationship, all that is necessary to furnish a basis for an action of negligence is that there be present the elements necessary to establish such a cause of action, and if that is so, that [the] relationship is one of contract is no sound reason why the action should not lie."*Id.* However, "a mere breach of contract would not afford a basis for recovery in tort, [and thus] the necessary elements to establish negligence must be shown . . ." *Id.*, 409.

In the present case, as noted in *Stowe*, the plaintiffs may plead negligence, even though the negligence claim arises out of the same set of facts as the breach of contract claim. Construing the allegations of the complaint in the light most favorable to the plaintiffs, the complaint alleges that the defendant owed a duty to the plaintiffs and that the defendant breached that duty when it mishandled their insurance claim. The complaint further alleges that as a result of the defendant's action, the plaintiffs sustained physical injuries. The allegations of the complaint are, therefore, sufficient to plead a cause of action in negligence. Accordingly, the motion to strike is denied as to count six.

Analysis

In general, a bad faith claim of failure to settle should not prevail in a defensible case simply because a claim may exceed policy limits and a verdict in fact exceeds policy limits for two reasons. First, an insured does not have a "right" under most policies to mandate payment of policy limits absent liability. Second, electing to defend a defensible case in lieu of paying policy limits is not likely to be motivated by malice toward the insured. Consequently, demands that policy limits be paid are often couched in terms of characterizing claims as "valid" or likely to be successful.

The problem is that plaintiffs' counsel claim that insureds have an implied right to be protected from personal exposure despite the defensibility of cases. This is stated in most policies and is not explicitly addressed by the cases reviewed above. However, phrases which refer to balancing rights of the insurer and insured or putting the insurer's rights ahead of the insured's rights, blur the lines insofar as they do not appear to require a showing of malice. Where bad faith signifies malice and where malice does not exist, plaintiffs may pursue a claim of breach of fiduciary duty or negligent failure to settle. There are limits to these claims. For example, the economic damages rule may preclude a claim of negligence. Further, an insurer can usually show that the decision to defend a defensible case was reasonable. The impact upon insurers, therefore, is the cost of defending such claims and concern that these issues will be submitted to jurors who may be antagonistic to insurers, especially defending cases against sympathetic plaintiffs, whether they be the original plaintiffs who suffered personal injuries or insureds found liable for those injuries.

Recommendations

In Connecticut, insurers must be cognizant of the different ways of plaintiffs may characterize rights of insureds vis-a-vis insurers in terms of balancing of rights or not having the insurer put its rights ahead of insureds. They must also be aware of theories of liability other than bad faith, including "breach of fiduciary duties," and "negligent failure to settle." Claims of negligent failure to settle and breach of fiduciary duties seem to be rarely used but may permit an action where malice cannot be shown and may make it easier to raise a factual issue requiring determination by a jury. If negligence is asserted, it is important to remember that such a claim is not viable where damages are purely economic.

Regardless of the potential theory of liability, an insurer should ideally articulate a reasonable basis for its evaluation of settlement demands and communicate them, insofar as possible, to insureds. Insurers are aware of the

importance of the claim file – and difficulties that claims handlers have in that regard in articulating pros and cons of trying a case. However, some do not communicate their evaluations absent a settlement demand, in part because most insureds simply want insurers to "handle" claims with minimal involvement of the insureds.

The role of defense counsel may complicate the communications process. It is customary for defense counsel to advise insureds of demands. It is less common for defense counsel to formally advise insureds of the rationale for an insurer's evaluation in part because evaluations are on-going and in part because lack of settlement reflects the insurer's decision to not settle. Defense counsel often provides evaluations of cases, i.e., likelihood of success or failure and verdict range, but they are only probabilities and they are often imprecise. Insofar as defense counsel is an advisor and not a decision maker regarding settlement demands, it is not common for defense counsel to explain why a demand is being rejected. Accordingly, insurers may consider communicate their rational for accepting or rejecting settlement demands to insureds. If this cannot be done directly because of lack of confidentiality between an insurer and insured, at least in Connecticut, it can be done through counsel who can then advise the insured or the insured's personal counsel. The insured may disagree (and will undoubtedly disagree where there is an attempt to build a bad faith case), but the process should at least reflect a sincere attempt to make a reasonable assessment of the case and the contractual basis of the assessment.

If an excess verdict occurs, an insurer should ideally minimize friction with the insured. Communication is vitally important. The insurer might help to defray the cost of the insured's personal counsel to reduce pressure while post-verdict proceedings ensue. Insureds need to know that threats of pursuing personal assets are often only negotiating tools by plaintiff's counsel.

At some point, the law needs to be clarified. The purpose of law is to clarify rights and make conduct predictable. Insurance contracts are intended to spell out the rights of the parties. If every potentially large case raises the specter of extra-contractual damages simply because of exposure, without regard to the defensibility of the claim, this increases the stakes of litigation, it prolongs litigation and deprives the parties of the certainty that the law – and insurance contracts – are intended to provide. ■

MEALEY'S LITIGATION REPORT: INSURANCE BAD FAITH
edited by Timothy J. Raub
The Report is produced twice monthly by

1600 John F. Kennedy Blvd., Suite 1655, Philadelphia, PA 19103, USA
Telephone: (215)564-1788 1-800-MEALEYS (1-800-632-5397)
Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
ISSN 1526-0267