

**BAD FAITH DURING LITIGATION**  
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PLRB/FDCC CRITICAL ISSUES SEMINAR

Insureds are now exploring new methods to recoup extra contractual damages. Previously, insureds focused upon the insurer's "behavior" before instituting the bad faith litigation. The new frontier is an insurer's action during the bad faith litigation itself.

**I. CONDUCT AMOUNTING TO BAD FAITH IN LITIGATION**

**O'Keefe v Safeco Insurance Co. of America**, 55 Ore. App. 811, 639 P.2d 1312 (Or. App. 1982) - The insured filed a bad faith action against her insurer based upon defense counsel's conduct in defending the insured in a personal injury case. Specifically, the insured argued that defense counsel: (a) failed to take the plaintiff's deposition; (b) failed to obtain the plaintiff's medical records; (c) failed to obtain the plaintiff's financial records; (d) failed to take the deposition of the plaintiff's doctors; and (e) failed to secure adequate medical consultation for the benefit of the insured. A jury returned a verdict for the insured, and the insurer appealed. The appellate court found that a cause of action could be maintained against the insurer for defense counsel's conduct.

**White v. Western Title Ins. Co.**, 710 P.2d 309 (1985) - In *White* the California Supreme Court held an insurer's duty of good faith and fair dealing survives the onset of litigation and evidence of the insurer's conduct during litigation is admissible to show the insurer's breach of the covenant of good faith and fair dealing.

**Kauffman v. Aetna Casualty & Surety Co.**, 794 F. Supp. 137 (E.D. Pa. 1992) - In *Kauffman*, Judge Pollak noted that "this case presents an unusual situation in that plaintiffs allege bad faith, not in the pre-litigation handling of their claim, but in conduct that occurred during the pendency of litigation, at a stage when Aetna's declaratory judgment action was before the Third Circuit." The Kauffmans alleged three acts of bad faith: (1) Aetna's insistence on proceeding to arbitration, rather than paying the proceeds, (2) Aetna's opposition to the Kauffmans' motion to confirm the arbitration award in a state court, and (3) Aetna's refusal to pay the remaining amount of the arbitration award until the Third Circuit rendered a decision on Aetna's appeal. Judge Pollak's discussion of the Kauffmans' claims on their merits, even though he ruled that Aetna did not act in bad faith, provides an indication, albeit implicit, that the Pennsylvania bad faith statute covers post-denial of claim conduct in the litigation arena.

**O'Donnell v. Allstate Insurance Co.**, 734 A.2d 901 (Pa. Super. 1999) - Interpreted the Pennsylvania bad faith statute to encompass conduct of an insurer before, during, and after litigation as evidence of bad faith (though “after” not followed as dicta in *Ridgeway v. United States Life Credit Life Ins. Co.*, *infra*.)

**General Refractories Co. v. Fireman's Fund Ins. Co.**, 2002 U.S. Dist. LEXIS 25324, 2002 WL 376923 (E.D. Pa.), *aff'd in part and rev'd in part*, 337 F.3d 297, 302 (3d Cir. 2003) - The Third Circuit affirmed the trial Court's denial of the carrier's Motion to Dismiss where the insured alleged the following intra-litigation conduct was bad faith: (1) a pattern of delay, stonewalling, deception, obfuscation and pretense; (2) intentionally withholding critical documents; (3) ignoring court orders; (4) testifying falsely at depositions, with litigation counsel fully aware of the false testimony; (5) misrepresenting facts to the trial court and opposing counsel; (6) providing incomplete responses, unreasonable objections, unfounded claims of privilege and intentionally incomplete privilege logs in response to reasonable and relevant requests; (7) using an overly broad, clearly untenable theory of privilege to conceal the knowledge, activity and intent which formed the basis of the insurance coverage action; (8) actively hiding highly probative documents while moving for summary judgment on the issues to which the hidden documents related; (9) using hidden documents during a deposition; (10) continuing to locate hundreds of documents that should have been produced or put on privilege logs, each time claiming that they had just been found; (11) engaging in obdurate conduct, including actions demonstrating an attempt to obstruct the discovery process and (12) encouraging witnesses to provide false and misleading testimony. The Court held that the above conduct constituted, “more than just discovery abuses.” (See “More than Discovery Abuses” - the Pennsylvania Rule, *infra*).

## II. CONDUCT NOT AMOUNTING TO BAD FAITH IN LITIGATION

**Jung v. Nationwide Mut. Fire Ins. Co.**, 949 F. Supp. 353, 360 (E.D. Pa. 1997) - “An aggressive defense of the insurer's interest is not bad faith.”

**Sims v. Travelers Insurance Co.**, 16 P.3d 468 (Okla. Civ. App. 2000), the insureds alleged that the lawyers for the insurer had treated them as adversaries; filed motions to dismiss; objected to discovery; did not take depositions at the times the insureds offered to produce witnesses for deposition; misdocketed meetings; and, rejected the insureds' request for mediation. The Court held that the litigation conduct alleged cannot be the basis for a bad faith action.

**Monarch, Inc. v. St. Paul Prop. & Liab. Ins. Co.**, 2004 U.S. Dist. LEXIS 14803 (E.D. Pa. 2004) - Not bad faith to raise two-year limitations defense in Answer because when the carrier filed its Answer, it had a good-faith argument that the two-year limitations period applied. Thus, its decision to invoke the provision did not constitute bad faith even though they may not ultimately prevail on that interpretation.

### III. THE LITIGATION PRIVILEGE

The litigation privilege generally provides that since the external threat of liability is destructive and inconsistent with the effective administration of justice, Courts apply the privilege to eliminate the threat of liability for communications made during all kinds of truth-seeking proceedings: judicial, quasi-judicial, legislative, and other official proceedings. It has been used to attack the validity of claims for bad faith arising out of conduct in litigation.

**Tucson Airport Authority v. Certain Underwriters at Lloyd's, London**, 918 P.2d 1063 (Ariz. App. 1996) - In *Tucson Airport*, a class action was filed against the insured for harm caused when it released a toxic chemical into groundwater. The insured subsequently filed a declaratory judgment action against its insurers to determine coverage in the underlying action. During the course of the litigation in the declaratory judgment action, the insured amended its complaint to state a bad faith claim against the insurers for engaging in misconduct during the declaratory judgment action. The insurers moved to dismiss, arguing that the alleged misconduct did not constitute bad faith and that, if it did, it was absolutely privileged under Arizona law. The trial Court granted the motion and dismissed the bad faith claim. On appeal, the court of appeals reversed, rejecting the argument that the litigation privilege barred the bad faith claim. The Court reasoned that insured's bad faith claim was not a communication. Rather, the alleged bad faith was a course of conduct in which they failed to perform their duties fairly and in good faith.

**Physicians' Service v. Superior Court**, 9 Cal. App. Rptr. 4th 1321, 12 Cal. Rptr. 2d 95 (Cal. Ct. App. 1992) - *White v. Western Title Ins. Co.*, *supra*, "stands for the proposition that ridiculously low statutory offers of settlement may be introduced . . . as bearing on the issue of bad faith of the insurance company. . . . Defensive pleading, including the assertion of affirmative defenses, is communication protected by the absolute litigation privilege. Such pleading, even though allegedly false, interposed in bad faith, or even asserted for inappropriate purposes, cannot be used as the basis for allegations of ongoing bad faith. No complaint can be grounded upon such pleading."

### IV. "MORE THAN DISCOVERY ABUSES" - THE PENNSYLVANIA RULE

**W.V. Realty Inc. v. Northern Ins. Co.**, 334 F.3d 306 (3d Cir. 2003) - Under Pennsylvania insurance law, those cases in which courts have permitted bad faith claims to go forward based on conduct which occurred after the insured filed suit all involved something, beyond a discovery violation, suggesting that the conduct was intended to evade the insurer's obligations under the insurance contract. However, there are some cases in which the insurer's conduct during the course of the litigation is both a violation of discovery rules and a violation of the insurer's fiduciary duty to the insured.

**Gallatin Fuels, Inc. v. Westchester Fire Ins. Co.**, 2006 U.S. Dist. LEXIS 1327 (W.D. Pa. 2006) - Though an insurer's conduct during the pendency of litigation may be considered as evidence of bad faith under Pennsylvania's bad faith statute, it is only relevant where the conduct shows the insurer's intent to evade its obligations under a policy.

## V. RULES OF CIVIL PROCEDURE CONTROL BAD FAITH IN LITIGATION

**Timberlake Construction Co. v. USF&G**, 71 F.3d 335 (10th Cir. 1995) - The Tenth Circuit held that evidence of litigation conduct should not be admitted as proof of bad faith on the grounds of public policy. "To hold otherwise, would deny insurance attorneys from 'zealously and effectively' advocating on behalf of their clients." The court in *Timberlake* reasoned that once litigation commences, other rules, particularly the Rules of Civil Procedure, provide redress for improper conduct of litigants.

**Rottmund v. Continental Assurance Co.**, 813 F. Supp. 1104, 1106 (D. Pa. 1992) - The Court was presented with the carrier's Motion In Limine to exclude the insured's bad faith claim because the date of denial occurred before the Pennsylvania bad faith statute's effective date of July 1, 1990. The Court ruled against the carrier because the insured alleged bad faith conduct during the litigation (after the statute's effective date). Furthermore, the Court ruled that F.R.C.P. 26(g) and 37(a)(2), which provide for sanctions for harassment, unnecessary delay, or needless increase in the cost of litigation in the course of discovery, do not preempt bad faith claims for the conduct of insurers, even where that bad faith conduct occurs in the context of litigation.

**Zurich Am. Ins. Co. v. ABM Indus.**, 265 F. Supp. 2d 302, 310 (S.D.N.Y. 2003), *rev'd in part on other grounds*, 397 F.3d 158 (2d Cir. 2005) - While bad faith litigation was pending, denied the insured's Motion to Amend to add claims of bad faith for conduct of the carrier during the pending bad faith litigation. After calling the request "untimely," the Court also noted that the insured could have petitioned the Court for Sanctions at the time of the alleged violations.

## VI. PAYMENT OF CLAIM DOES NOT PROTECT INTRA-LITIGATION BAD FAITH

**Hollock v. Erie Ins. Exch.**, 842 A.2d 409, (Pa. Super. Ct. 2004) - The insured acted in bad faith since "most of the testimony of [the carrier's] employees was an intentional attempt to conceal, hide or otherwise cover-up the conduct of [its] employees in the handling of the [insured's] claim." The Court rejected the argument that because the carrier paid benefits due on the underlying claim when the current bad faith action was tried, its conduct during trial cannot be deemed bad faith. Currently on appeal to the Pennsylvania Supreme Court.

## VII. ONLY IF INSURER HAS KNOWLEDGE

Givens v. Mullikin ex rel. Estate of McElwaney, 75 S.W.3d 383, 396 (Tenn. 2002) - The Supreme Court of Tennessee held that intra-litigation conduct could support a bad faith claim against the insurer to the extent that the insurer had knowledge of the conduct.

## VIII. KNOWLEDGE OF INSURER NOT NEEDED

Barefield v. DPIC Cos., 600 S.E.2d 256 (W. Va. 2004) - The Supreme Court of Appeals of West Virginia, upon an interlocutory certified question, held that a carrier could be liable for bad faith under the West Virginia Unfair Trade Practices Act. Though the conduct during litigation in *Barefield* fell short of bad faith, the Court recognized that intra-litigation conduct could be bad faith, whether due to the independent judgment of the insurer's counsel, or through participation and/or ratification of the carrier.

## IX. POST-LITIGATION BAD FAITH

O'Donnell v. Allstate Insurance Co., 734 A.2d 901 (Pa. Super. 1999) - In dicta, the Court stated that to sustain a bad faith cause of action premised on post-litigation misconduct, a plaintiff must allege "conduct sufficiently egregious to be considered [grossly] reckless or otherwise committed with the [specific] intent of improperly avoiding payment of [a] claim."

Ridgeway v. United States Life Credit Life Ins. Co., 793 A.2d 972 (Pa. Super. Ct. 2002) - The carrier was granted permission by the trial Court to seek appellate review of an interlocutory Order which held that an insured can bring a second bad faith action for a carrier's failure to pay the proceeds of a settlement or judgment obtained from the first bad faith suit. The Court ruled that the trial court erred in concluding that an insured has a cause of action for the carrier's alleged bad faith following a settlement and judgment. Rather, the insured's remedy for non-payment of the judgment was provided for by the Pennsylvania Rules of Civil Procedure for the enforcement of money judgments. Also, the insured could enforce the settlement agreement pursuant to the law on contracts. The Court declined to follow dicta from *O'Donnell* which suggested that post-litigation conduct could be bad faith.

Givens v. Mullikin ex rel. Estate of McElwaney, 75 S.W.3d 383 (Tenn. 2002) - "[C]ases in which an insurer may be held liable [for post-litigation misconduct] will be rare indeed."

## X. INTRA-LITIGATION EVIDENCE ADMISSIBLE TO ESTABLISH BAD FAITH

Other jurisdictions, while not expressly addressing the issue of the viability of the duty of good faith after commencement of litigation, have implicitly approved the concept by allowing admission of evidence of the insurance company's conduct that occurred after the commencement of litigation. See, e.g., T.D.S. Inc. v. Shelby Mut. Ins. Co., 760 F.2d 1520 (11th Cir. 1985)(applying Florida law: "Certainly the litigation conduct of [the insurer] was relevant to the claim that [the insurer] or those acting on its behalf dealt dishonestly with [insured]."); Southerland v. Argonaut Ins. Co., 794 P.2d 1102 (Colo. Ct. App.1989) (holding that admission of evidence of post-filing conduct was not an abuse of discretion because the evidence helped establish a habitual pattern of dealing with the plaintiff); Home Ins. Co. v. Owens, 573 So.2d 343, 344 (Fla. Dist. Ct. App. 1990) (Upholding admission of an insurer's pleadings as well as the insurer's failure to answer a request for admissions, the court held that the insurance company's litigation conduct was admissible, relevant evidence.); Spadafore v. Blue Shield, 486 N.E.2d 1201 (Ohio Ct. App. 1985) ("Evidence of the breach of the insurer's duty to exercise good faith occurring after the time of filing suit is relevant so long as the evidence related to the bad faith or handling or refusal to pay the claim."); Barefield v. DPIC Companies, Inc., 600 S.E.2d 256 (W.Va. 2004) (allowing the introduction of evidence of alleged misconduct by defense counsel during litigation, so long as the insurer knowingly encourages, directs, participates in, relies upon or ratifies such alleged wrongful conduct).

## XII. INTRA-LITIGATION EVIDENCE NOT ADMISSIBLE TO ESTABLISH BAD FAITH

Nies v. National Auto. & Casualty Ins. Co., 199 Cal.App.3d 1192, 245 Cal. Rptr. 518 (Cal. Ct. App. 1988) (holding that insurers will be disabled from conducting a vigorous defense in a bad faith insurance action if their pleadings may be used to prove pre-existing bad faith); Tomaselli v. Transamerica Ins. Co., 25 Cal. App. 4th 1766, 31 Cal.Rptr.2d 224 (Cal. Ct. App. 1994) (claim for bad faith cannot be based on an insurer's appeal from an adverse judgment). In essence, California's approach has evolved to allow the introduction of unreasonable settlement behavior (specifically, low settlement offers) that occurs after suit has been filed while prohibiting the admission of litigation conduct, techniques, and strategies.

Palmer v. Farmers Ins. Exchange, 861 P.2d 895 (Mont. 1993) - Public policy favors the exclusion of evidence of an insurer's post-filing litigation conduct in at least two respects. First, permitting such evidence is unnecessary because during the initial action, trial courts can assure that defendants do not act improperly. Next, and more importantly, the introduction of such evidence hinders the right to defend and impairs access to the courts. The Rules of Civil Procedure control the litigation process and generally provide adequate remedies. But See Federated Mut. Ins. Co. v. Anderson, 991 P.2d 915

(Mont. 1999) (allowing some litigation conduct, specifically meritless appeals, to be introduced as evidence of bad faith).

### XIII. EVIDENTIARY CONCERN?: PROBATIVE V. PREJUDICIAL

Knotts v. Zurich Ins. Co., 2006 Ky. LEXIS 136 (Ky. 2006) - The Kentucky Supreme Court, in reversing the trial Court and intermediate appellate Court, meticulously analyzed the benefits and drawbacks of allowing such evidence to be presented. The Court held that the Kentucky bad faith statute continues to apply during litigation of an insurance claim. However, the Court implicitly recognized that the introduction of evidence of an insurer's litigation conduct would generally be prohibited under the Kentucky version of F.R.E. 403.

### XIV. NO BAD FAITH DURING LITIGATION

Premium Finance Co. v. Employers Reinsurance Corp., 761 F. Supp. 450 (W.D. La. 1991) - The Court in *Premium Finance* determined that the purpose of the Louisiana bad faith statute was to provide an incentive to insurance companies to quickly resolve claims and avoid litigation costs. It stated that it would be duplicative for the statute to apply once litigation is commenced, since, "any party to a lawsuit will have an incentive to settle the suit, namely, the desire to avoid litigation costs." The Court called the opposite interpretation "absurd."

Arkansas and Wyoming are also representative of this rule. See Parker v. Southern Farm Bureau Cas. Ins., 935 S.W.2d 556 (Ark. 1996); Roussalis v. Wyoming Medical Center, Inc., 4 P.3d 209 (Wyo. 2000) (Disallowed the bad faith claim based on intra-litigation conduct. Such conduct is controlled by the Rules of Civil Procedure). This approach amounts to the denial of the continuing existence of a duty of good faith once litigation begins.