Assurances

Assurances

The Insurance Company's Right to be Wrong

Douglas G. Houser

Volume 61, Number 2, 1993

URI: https://id.erudit.org/iderudit/1104947ar
DOI: https://doi.org/10.7202/1104947ar

See table of contents

Publisher(s)

HEC Montréal

ISSN

0004-6027 (print)
2817-3465 (digital)

Explore this journal

Cite this document

Houser, D. (1993). The Insurance Company's Right to be Wrong. *Assurances*, *61*(2), 225–238. https://doi.org/10.7202/1104947ar

Article abstract

En accordant aux compagnies d'assurance le droit de contester certaines réclamations, les tribunaux américains concourent à rétablir un juste équilibre entre le droit du demandeur a obtenir des dommages et intérêts lorsqu'une réclamation lui est intentionnellement et injustement niée et le droit de la compagnie d'assurance à refuser d'indemniser le demandeur pour un sinistre qu'elle juge douteux. Reconnaître la bonne foi comme étant une affaire de loi contribue, à long terme, à réduire les primes d'assurance et à rendre plus stable l'expérience des compagnies d'assurances. Celles-ci ont aussi le droit, selon l'auteur, de commettre des erreurs en toute bonne foi.

The Insurance Company's Right to be Wrong*

by

Douglas G. Houser**

En accordant aux compagnies d'assurance le droit de contester certaines réclamations, les tribunaux américains concourent à rétablir un juste équilibre entre le droit du demandeur à obtenir des dommages et intérêts lorsqu'une réclamation lui est intentionnellement et injustement niée et le droit de la compagnie d'assurance à refuser d'indemniser le demandeur pour un sinistre qu'elle juge douteux.

Reconnaître la bonne foi comme étant une affaire de loi contribue, à long terme, à réduire les primes d'assurance et à rendre plus stable l'expérience des compagnies d'assurances. Celles-ci ont aussi le droit, selon l'auteur, de commettre des erreurs en toute bonne foi.

~

Introduction

One of the biggest concerns insurance companies (and insurance company executives)[1] face is the dramatic rise in

---

* Published in the *Tort & Insurance Law Journal*, Volume XXVII, Number 3, Spring 1992 and reprinted by permission of the American Bar Association (Copyright © 1993 American Bar Association.

** Douglas G. Houser is a partner in Bullivant, Houser, Bailey, Pendergrass & Hoffman, Portland, Oregon. He received his J.D. from Stanford University and is Past Chair of the Tort & Insurance Practice Section of the American Bar Association.

[1] Republic Ins. Co. v. Hires, 810 P. 2d 790, 796 n.5 (Nev. 1991) (suggesting the possibility of a shareholders' "class action suit against the insurance company employees responsible for the acts giving rise to a "bad faith" punitive damages award); Kornblum, *Current State of Bad Faith and Punitive Damage Litigation in the U.S.*, 23 Tort & Ins. L.J. 812, 813-14 (1988).

potential liability for extracontractual damages for "bad faith" in first-party claims. Many courts have recognized the misuse and abuse by claimants and overly aggressive plaintiffs' lawyers who frequently make unfounded "boilerplate" allegations of "bad faith" in virtually every first-party claim related to a coverage or claims handling dispute.[2] Plaintiffs' advocates alleging "bad faith" against insurers for the alleged mishandling of their insureds' claims result in jury verdicts and "blood money" settlements that probably cost insurance companies and the insurance-buying public hundreds of millions of dollars each year.[3]

The tort of first party bad-faith is usually said to have originated in California in 1968[4] and is sometimes referred to as the "second California gold rush."[5] Thirty-five jurisdictions now appear to recognize a first party bad faith cause of action.[6] Fourteen states appear to have rejected first-party "bad faith" claims.[7]

The standard for first party bad faith frequently varies from state to state. Often a subjective element is required to determine whether the insurer, in bad faith, denied or delayed payment of a claim.[8] Claimants must prove the insurer's blameworthy state of

---

[2] *See* LITIGATION RESEARCH GROUP, INSURANCE BAD FAITH VERDICTS & SETTLEMENTS 42-43, 46 (T. Hicks ed. 1986) (hereinafter VERDICTS), (citing Mason v. National Indem. Co., No. P-535 (S.D. Miss. May 1984) (bad faith claim settled for $145,000 over $10,000 uninsured motorist coverage dispute); Fisher v. Twentieth Century Ins. Co., C 289 277 (Cal. Super. Cr. 1984) (delay in paying $544 for auto repair resulted in $600,000 verdict for plaintiff).

[3] Komblum, *supra*, at 821. The total amount of punitive damages against insurance companies in California courts between January 1983 to March 1985 was over $165 million. Komblum, *First Party Insurance Bad Faith: A Defense Perspective*, 1 D.R.I. 2 n. 1 (1988). For general information on bad faith verdicts and settlements, see VERDICTS *supra* note 2.

[4] *See* Wetherbee v. United Ins. Co., 71 Cal. Rptr. 764 (Ct. App. 1968).

[5] Caffrey, *Bad Faith: A Commentary*, 17 U. WEST L.A. L. REV. 1, 4 (1985).

[6] S. ASHLEY, BAD FAITH ACTIONS, LIABILITY AND DAMAGES, § 2.22, at 65 (1985 & Supp. 1991); *if.*, § 5.02, at 2. (hereinafter ASHLEY).

[7] ASHLEY, *supra* note 6, § 2.22. The law in Illinois and Maine remains unclear.

[8] *See* Washington v. Group Hospitalization, Inc., 585 F. Supp. 517 (D.D.C. 1984); Atlas Carriers, Inc. v. Transport Ins. Co., 584 F. Supp. 50 (E.D. Ark. 1983); Coleman v. Gulf Life Ins. Co., 514 So. 2d 944 (Ala. 1987); Hawkins v. Allstate Ins. Co., 733 P. 2d

mind in denying or delaying payment. The courts have recognized that insurers have a duty to question appropriate claims and that there is no duty to pay claims for which there is no coverage. An emerging national trend is clearly developing in response to first-party bad faith actions.

The courts seem to have recognized and are becoming increasingly sensitive to the fact that insurance companies are as equally obligated to *deny* "bad" claims as they are to *pay* "good" claims. Insurance companies and society in general cannot afford the "bad faith-punitive damages lottery" that permits a few insureds to recover millions of dollars in extra damages that must then ultimately be paid by the great mass of innocent premium-paying insureds. Courts are increasingly willing to dismiss bad faith claims as a mater of law where the insurer has an arguable or "fairly debatable" basis for denying coverage or delaying payment. Courts are increasingly willing to dismiss bad faith claims as a matter of law where the insurer has an arguable or "fairly debatable" basis for denying coverage or delaying payment. Courts recognize that the insurer ought to be able to challenge a fairly reasonably debatable claim without facing a bad faith claim. Recently, many states have adopted standards requiring clear and convincing evidence before awarding punitive damages.[9] In addition, there has been a greater acceptance of summary judgment motions.[10] The acceptance by many states of the principle that insurance companies have a good faith right to be wrong as a matter of law is proving to be a lethal weapon in the defense of unfounded bad faith claims.

The Reasonableness Test

The test for good faith is sometimes said to be the Biblical Golden Rule: "Do unto others as you would have them do unto you." Lawyers sometimes call this "reasonableness." While the standard for first-party bad faith varies from jurisdiction to

1073 (Ariz.), *cert. denied*, 484 U.S. 874 (1987); Travelers Ins. Co. v. Savio, 706 P. 2d 1258 (Colo. 1985); ASHLEY, *supra* note 6, § 5.02, at 2.

[9]1987 Ala. Acts 87-185; Ind. Code § 34-4-34-2.

[10]Celotex Corp. v. Catrett, 477 U.S. 317, 327 (1986).

jurisdiction, all jurisdictions seem to incorporate some form of reasonableness standard. The most common is a two-part test, or the "fairly debatable" test.

The two-part test for first-party bad faith is followed by many jurisdictions.[11] Under this test, "bad faith" claimants have the burden to prove: (1) that the insurer's conduct was both unreasonable and (2) that the insurer intentionally denied a claim or delayed payment of a claim that the insurance company knew to be valid or showed a reckless disregard of the fact that a valid
228 claim had been submitted.

Courts uniformly reject a strict liability standard for bad faith claims,[12] and most have held that negligence alone is insufficient to trigger liability on an insurer for the tort of bad faith.[13] Therefore, to satisfy the "fairly debatable" test, the plaintiff must "go beyond a mere showing of nonpayment and prove a bad faith nonpayment, a nonpayment without any reasonable ground for dispute."[14] In other words, bad faith requires the showing of a "frivolous or unfounded refusal to pay."[15]

Under the reasonableness inquiry, courts must determine whether a reasonable insurer under the particular facts and circumstances would have denied or delayed payment of the claim. The absence of a legitimate, arguable, or fairly debatable reason for denial of coverage is one of the ultimate material facts

---

[11] *See, e.g.*, National Sec. Fire & Cas. Co. v. Bowen, 417 So. 2d 179, 183 (Ala. 1982); Linthicum v. Nationwide Life Ins. Co., 723 P. 2d 703, 711 (Ariz. Ct. App. 1985), *modified*, 723 P. 2d 675 (Ariz. 1986); Travelers Ins. Co. v. Savio, 706 P. 2d 1258 (Colo. 1985); Koral Indus. v. Security Conn. Life Ins. Co., 788 S.W. 2d 136, 147 (Tex. Ct. App.), *writ denied*, 802 S.W. 2d 650 (1990).

[12] *See, e.g.*, McLaughlin v. Alabama Farm Bureau Mut. Cas. Ins. Co., 437 So. 2d 86, 89-90 (Ala. 1983); ASHLEY, *supra* n. 6, § 5:03, at 6.

[13] *See, e.g.* Trus Joist Corp. v. Safeco Ins. Co. of Am., 735 P. 2d125 (Ariz. Ct. App. 1987).

[14] National Sav. Life Ins. Co. v. Dutton, 419 So. 2d 1357, 1361 (Ala. 1982).

[15] United Nuclear Corp. v. Allendale Mut. ins. Co., 109 P. 2d 649, 654 (N.M. 1985).

upon which the insured claimant has the burden of proof.[16] As long as the insurer has a reasonable basis for denying or delaying payment, the insurer should not be liable for bad faith. This is a simple matter of fairness. All persons, including insurance companies, should have the right to their day in court. The price of losing a trial should not be millions of dollars in punitive damages.

While the plaintiff has the burden to show that the insurer was unreasonable, the insurer may want to make out a prima facie case of reasonableness to foreclose any bad faith claim. For example, arson may be an affirmative defense to a first-party fire insurance claim. In most jurisdictions, an insurer makes a prima facie case of arson and, therefore, "reasonableness" to defeat a bad faith claim when it shows through circumstantial evidence that: (1) the fire was of incendiary origin; and (2) that the insured had a motive.[17] It should only be necessary to show that reasonable persons could believe these elements existed after a reasonable investigation.[18] If a jury question on the issue of arson is present then "reasonable minds could disagree" about whether a plaintiff engaged in arson. Therefore, the insured should not be entitled to recover on a "bad faith" claim as a matter of law.[19] The insurance company should have the right to be wrong.

If the claimant hopes to avoid dismissal of bad faith claims as a matter of law, the claimant must try and make a showing of

---

[16]*E.g.*, Williamson v. Emasco Ins. Co., 696 F. Supp. 1583 (W.D. Okla. 1988); Bryant v. Kemper Ins. Co., 542 A. 2d 347 (Del. Super. 1988); Greene v. Truck Ins. Exch., 753 P. 2d 274, 279 (Idaho 1988), *rev. denied*, 776 P. 2d 829 (Idaho 1989); Hopkins v. North Am. Co. for Life & health Ins., 594 S.W. 2d 310, 318 (Mo. Ct. App. 1980); Nelms v. Tennessee Farmers Mut. Ins. Co., 613 S.W. 2d 481 (Tenn. Ct. App. 1978).

[17]*See* D. WALL, LITIGATION AND PREVENTION OF INSURER BAD FAITH § 11.11, at 380 (1985).

[18]*See* Continental Cas. Co. v. Howard, 775 F. 2d 876, 879-81 (7th Cir. 1985) (applying Indiana law), *cert. denied*, 475 U.S. 1122 (1986); Davidson v. State Farm Fire & Cas. Co., 641 F. Supp. 503, 507, 510 (N.D. Miss. 1986); Harrison v. Nationwide Mut. Fire Ins. Co., 580 F. Supp. 133, 135-36 (E.D. pa. 1983); Watson v. State Farm Fire & Cas. Co., 461 N.E. 2d 57, 59-61 (Ill. Ct. App. 1984); Travelers Indem. Co. v. Woods, 663 S.W. 2d 392, 397 (Mo. Ct. App. 1983).

[19]*E.g.*, St. Paul Lloyd's Ins. Co. v. Fong Chun Huang, 808 S.W. 2d 524 (Tex. Ct. App.), *error denied* (Sept. 5, 1991).

knowledge or recklessness by the insurance company through the lack of a reasonable basis for denial of a claim.

> The second element of the test reflects a reasonable balance between the right of an insurance carrier to reject a non-compensable claim submitted by its insured and the obligation of such carrier to investigate and ultimately approve a valid claim of its insured. If an insurer does not know that its denial or delay in processing a claim filed by its insured is unreasonable, and does not act with reckless disregard of a valid claim, the insurer's conduct would be based upon a permissible, albeit mistaken, belief that the claim is not compensable.[20]

An insurance company's potential extracontractual liability for denial of claims requires that the insured in the first-party context establish the insurance company's knowledge or reckless disregard that a valid claim was submitted. This "right to disagree" rule[21] is premised on the theory that

> the insurer is permitted to dispute its liability in good faith because of the prohibitive social costs of a rule which would make claims non-disputable. Insurance companies burdened with such liability would either close their doors or increase premium rates to the point where only the rich could afford insurance.[22]

Numerous jurisdictions have expressly or by implication adopted the rule that an insurer may deny a claim without fear of incurring bad faith liability if the denial was based on a debatable or arguable question.[23] That being the case, the courts of this nation appear increasingly willing to dismiss "bad faith" claims *as a matter of law* through pretrial motions.

---

[20]Travelers Ins. Co. v. Savio, 706 P. 2d 1258, 1275 (Colo. 1985).

[21]Westers v. Auto-owners Ins. Co., 711 F. Supp. 946 (S.D. Ind. 1989).

[22]*Id.* at 948-49 (quoting Vernon Fire & Cas. ins. Co. v. Sharp, 349 N.E. 2d 173 (Ind. 1976)).

[23]*See* cases cited in Appendix.

If an insurer can produce sufficient evidence to create a jury issue on the question of coverage, then there is clearly a "fairly debatable" coverage question, and a court should dismiss any accompanying bad faith claim. A jury may ultimately determine that the insurance company was wrong on the issue of coverage, but the jury should not be permitted to consider imposition of extracontractual bad faith damages as a consequence of the company's challenge to the fairly debatable claim. "{W}here a claim is fairly debatable, the insurer is entitled to debate it and there is no bad faith on its part in doing so."[24]

Good Faith as a Matter of Law

Dutton Rule or the Directed Verdict Test

"Good faith as a matter of law" can be traced to the leading case of *National Savings Life Ins. Co.* v. *Dutton*.[25] In that case, the court set out the standard to be applied to the issue of whether the insurer had a reasonably debatable basis for denying coverage.

> {I}n the normal and ordinary case, if the evidence produced by either side creates a fact issue with regard to the validity of the claim and, thus, the legitimacy of the denial thereof, the tort claim must fail and should not be submitted to the jury.[26]

The *Dutton* court recognized that if the insurer took a reasonable position in regard to an insurance claim based on the evidence, then the insurer is not liable for bad faith as a matter of law. A bad faith claim should not be successful unless reasonable minds could not disagree about the insured's right to collect under the policy, and the court is prepared to enter a directed

---

[24]Dirks v. Farm Bureau Mut. Ins. Co., 465 N.W. 2d 857, 861 (Iowa 1991). *See also Westers*, 711 F. Supp. at 946; Knutilla v. Auto-Owners Ins. Co., 578 So. 2d 1359 (Ala. Civ. App. 1991); Aranda v. Insurance Co. of N. Am., 748 S.W. 2d 210 (Tex. 1988).

[25]419 So. 2d 1357 (Ala. 1982).

[26]State Farm Fire & Cas. Co. v. Balmer, 672 F. Supp. 1395 1403 (M.D. Ala. 1987), *aff'd.* 891 F. 2d 874 (11th Cir. 1990).

verdict for the claimant on an insurance contract claim. The Alabama court has said that to make out a *prima facie* case of bad faith, the plaintiff must be entitled to a directed verdict on his policy claim, but he need not actually obtain one.[27] Alternatively, if a directed verdict cannot be entered for the plaintiff because reasonable minds could disagree about the plaintiff's right to recover under the policy, then the insurance company should be entitled to a directed verdict on the plaintiff's bad faith claim. "This test is intended as an objective standard by which to measure plaintiff's compliance with his burden of
232 proving that defendant's denial of payment was without any reasonable basis either in fact or law;" that defendant's defense to the contract claim is not fairly debatable.[28]

The "directed verdict on the contract claim" test has been followed or applied by 36 states, as set out in the Appendix. Only three states seem to have explicitly rejected this test.[29] The analysis has been effectively applied in jurisdictions that determine first-party bad faith claims under either the two-part test or the "fairly debatable" standard.[30] Furthermore, an insurer need not wait until trial to have first-party bad faith claims dismissed as a matter of law. An insurer's good faith can

---

[27]Morton v. Allstate Ins. Co., 486 So. 2d 1263 (Ala. 1986).

[28]Safeco Ins. Co. of Am. v. Sims, 435 So. 2d 1219, 1224 (Ala. 1983) (Jones, J., concurring).

[29]Bilden v. United Equitable Ins. Co., 921 F. 2d 822 (8th Cir. 1990) (applying North Dakota law). For a critique condemning the "shallow and ill-formed decision" in *Bilden*, see bad Faith Law Report 42-43 (Mar. 1991); Linthicum v. Nationwide Life Ins. Co., 723 P. 2d 703, 712 (Ariz. Ct. App. 1985), *modified*, 723 P. 2d 675 (Ariz. 1986); Reuter v. State Farm Mut. Auto. Ins. Co., 469 N.W. 2d 250, 254 (Iowa 1991) ("We do not agree that the mere denial of a plaintiff's motion for a directed verdict automatically establishes that the issue is 'fairly debatable.'"). *See also* Robinson v. State Farm Fire & Cas. Co., 583 So, 2d 1063 (Fla. Dist. Ct. App. 1991) (rejecting good faith as a matter of law).

[30]International Indem. Co. v. Collins, 367 S.E. 2d 786 (Ga. 1988); Dirks v. Farm Bureau Mut. Ins. Co., 465 N.W. 2d 857 (Iowa 1991); St. Paul Lloyd's Ins. Co. v. Fong Chun Huang, 808 S.W. 2d 524 (Tex. Ct. App. 1991), *error denied*, (Sept. 5, 1991); St. Paul Fire & Marine Ins. Co. v. Cumiskey, 665 P. 2d 223 (Mont. 1983); Mills v. Regent Ins. Co., 449 N.W. 2d 294 (Wis. Ct. App. 1989). *See also infra* notes 35-51 and accompanying text.

frequently be decided before trail in a motion for summary judgment.[31]

Summary Judgment

It is well established that, as a general rule, summary judgment cannot be granted if there is a genuine question of fact about any material issue in dispute. However, in this instance, the insurance company can use that standard to assist in obtaining summary judgment on a first-party "bad faith" claim. If there is a question of fact about whether the plaintiff is entitled to coverage and recovery under the policy, then summary judgment should be entered in favor of the insurer on the bad faith claim. If plaintiff's contract claim is fairly debatable, and therefore must be decided by a jury, then the insurer should be entitled to summary judgment because it is entitled to contest debatable claims.

As it happens, this national trend permitting dismissal of bad faith claims as a matter of law coincides with an increased willingness on the part of courts to use summary judgment as a means of curtailing the "unwarranted consumption of public and private resources."[32] The U.S. Supreme Court recently added new teeth to the summary judgment motion, and federal courts in particular have responded.[33] "The Court has transformed the summary judgment motion into a pretrial directed verdict motion adopting both the burdens of proof and evidentiary weighing of the directed verdict."[34] The following representative cases

---

[31]*See* Polk v. Dixie Ins. Co., 897 F. 2d 1346 (5th Cir. 1990); Westers v. Autowners Ins. Co., 711 F. Supp. 946 (S.D. Ind. 1989); Williamson v. Emasco Ins. Co., 696 F. Supp. 1583 (W.D. Okla. 1988); Reliance Ins. Co.,v. Barile Excavating & Pipeline Co., 685 F. Supp. 839 (M.D. Fla. 1988); Stevenson v. Union Standard Ins. Co., 746 S.W. 2d 39 (Ark. 1988); AMCO Ins. Co. v. Stammer, 411 N.W. 2d 709 (Iowa Ct. App. 1987); Shields v. Nationwide Mut. Fire Ins. Co., 273 S.E. 2d 756 (N.C. Ct. App. 1981); Callioux v. Progressive Ins. Co., 745 P. 2d 838, 842 (Utah Ct. App. 1987).

[32]Celotex Corp. v. Catrett, 477 U.S. 371, 327 (1986).

[33]Matsushita Elec. Indus. Co. v. Zenith radio, 475 U.S. 574 (1986); Celotex Corp. v. Catrett, 477 U.S. 317 91986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986).

[34]Dolkart, *Summary Judgment in the Federal Courts After the Supreme Court Trilogy*, BARRISTER at 48-49 (Summer 1991).

illustrate the application of the "good faith as a matter of law" principle in motions for summary judgment.

Some Specific Examples of the Good Faith Standard

In *Bryant* v. *Federal Kemper Ins. Co.*,[35] the insurer, Kemper, moved for summary judgment and contended that the plaintiff failed to make out a claim for bad faith because the plaintiff did not show that the insurer's refusal to pay was without any reasonable justification. Kemper set out its
234 reasonable grounds for denying the claim. By showing that the basis for the denial was fairly debatable, Kemper met its burden to demonstrate the absence of a genuine issue of any material fact. The plaintiff, the nonmoving party, failed to show the existence of a genuine issue of fact—that is, that there was no arguable basis for denying the claim.[36] Because the plaintiff did not meet her burden of proof, summary judgment for Kemper was granted.

On the evening of Mach 21, 1981, Calamity Jane's Gambling Emporium and Saloon was intentionally set on fire in Livingston, Montana. In the underlying claim,[37] the corporation and its owner initially sued the insurer for a bad faith denial of the claim. The insurer moved for summary judgment and argued that, because the motive for arson by the owner was strong, a fairly debatable reason for denial existed. Therefore, the bad faith claim should be dismissed as a matter of law. The plaintiff also filed a cross-motion for summary judgment and alleged that the insurer's action was not reasonable. The state district court in Billings, Montana, denied both motions. Eventually the insurer received a unanimous jury verdict in its favor on both the coverage and good faith issues.

---

[35]542 A 3d 347 (Del. Super. Ct. 1988).

[36]In a motion for summary judgment, the nonmoving party "cannot just sit back and remain silent, but he must rebut by producing significant probative evidence" showing that there was no arguable basis for denial of the claim. Newell v. Hinton, 556 So. 2d 1037, 1041 (Miss. 1990). *Celotex* itself suggests that more is required of the nonmovant. *See* Dolkart, *supra* note 34, at 50.

In the second action arising from the fire,[38] First Security, the Mortgagee and assignee of a $350,000 loan to Calamity Jane's and its owner, sued the insurer to recover for the building loss. A contractor estimated that repair would cost $150,000, and the Small Business Administration, the assignor of First Security, demonstrated a proof of loss of approximately $350,000. First Security, however, sought nearly $450,000, which included $90,000 in lost interest payments suffered since Calamity Jane's default.

The insurer, while admitting liability for the payment of loss on the building, disputed the amount of damages. The insurer repeatedly offered to pay the undisputed amount of $207,000 but denied the remainder of the claim. The insurer moved for partial summary judgment to dismiss the bad faith and punitive damage claims as a matter of law.

The district court granted the insurer's motion and dismissed the bad faith claim.[39] The court relied on the good faith test:

> In order to establish a claim for bad faith, a plaintiff must prove that there was no reasonable basis for the insurance company's position or action. And where there is a reasonable basis for the insurance company's action, a claim of bad faith must be dismissed as a matter of law.[40]

Finding a "bona fide dispute" over the amount of damages to the building, the court held that a reasonable basis existed for the insurer's refusal to pay First Security's demand. Therefore, because there was a reasonable basis for denial, the bad faith claim was dismissed as a matter of law.

---

[37]Calamity Jane's Gambling Parlour & Saloon v. American Employees Ins. Co., No. 82-86-BLG (Mont. Dist. Ct. Feb. 8, 195).

[38]First Sec. Bank v. Commercial Union Ins. Co., No. 84-86-BU (D. Mont. 1985).

[39]*Id.* at 2.

[40]*Id.*

In a 1991 Texas "arson-slander" case,[41] the Happy Buddha Restaurant burned under suspicious circumstances. Just prior to the fire, the owner had obtained insurance from St. Paul, the defendant-insurer. The restaurant began hosting female impersonator shows after hours. The business was failing. Both the official arson investigator and an "independent" cause-and-origin expert reported that the cause of the fire was "arson for fraud." St. Paul denied the claim.

The plaintiff argued that, because St. Paul failed to identify
236 the person who set the fire, its investigation was inadequate and, therefore, that St. Paul breached its duty of good faith and fair dealing. Applying the good faith standard, the Texas Court of Appeals reversed the jury's finding against St. Paul on the bad faith claim.[42] The court reiterated an insurance carrier's right to deny questionable claims and held that insurers need only show a reasonable belief that the insured was at fault.[43] Therefore, to avoid the bad faith claim, it was sufficient that St. Paul established that the plaintiff's right to recover under the policy was fairly debatable owing to the evidence of arson and financial motive. St. Paul was not required to prove arson by the insured.

In a recent case in Nevada, the trial judge granted the insured's motion for summary judgment, dismissed all extracontractual damage claims, and held that the insurance company's declaratory judgment suit to get a determination of noncoverage was, in and of itself, evidence of the insurance company's good faith.[44]

In *Scott v. United of Omaha Life Ins. Co.*,[45] the district court granted the insured's motion for summary judgment as to coverage but also *granted* the insurance company's motion for

---

[41]St. Paul Lloyd's Ins. Co. v. Fong Chun Huang, 808 S.W.2d 524 (Tex. Ct. App. 1991), *error denied* (Sept. 5, 1991).

[42]*Id.* at 524.

[43]*Id.* at 526.

[44]Fremont Indem. Co. v. The Plaza Motel, No. A261456 (D. Nev. July 10, 1990).

[45]Scott v. United of Omaha life Ins. Co., 749 F. Supp. 1089 (M.D. Ala. 1990) (applying Alabama law), *aff'd*, 934 F. 2d 1265 (11th Cir. 1991).

summary judgment as to the insured's bad faith claim by finding the company had "at least an arguable reason" for denying the claim.[46] The court's ruling was affirmed without appeal by the Eleventh Circuit Court of Appeals.[47]

An example of a court's incorrect application of the good faith standard is found in *Silva v. Fire Ins. Exchange*.[48] Plaintiff's home burned on March 10, 1984. The parties conceded that the fire was of incendiary origin and plaintiff was prosecuted for arson, although the criminal charges were later dropped. Plaintiff submitted to her insurer a claim under her homeowner's policy for the loss. The insurer denied the claim, and plaintiff sued the insurer for bad faith.

The insurer moved for summary judgment on the ground that it had a fairly debatable basis in fact and law for denying payment because there was substantial circumstantial evidence that the insured caused the fire. The court, relying on precedent[49] set out the good faith test. However, it confused the analysis. The court determined that, because there was a genuine issue of fact regarding whether the plaintiff set the fire, the insurer's motion for summary judgment must be denied.

One commentator noted that the court "proceeded as if {the insurer} had moved for summary judgment on the issue whether {plaintiff} committed arson," which of course was not the basis of the motion.[50] Rather, the insurer asked for summary judgment on the reasonableness of its denial of payment on the claim. The circumstantial evidence clearly provided an arguable basis for the insurer's action. "Reasonable minds could disagree whether {the plaintiff} committed arson. {The plaintiff} would not have been entitled to {dismissal as a matter of law} on her breach of

---

[46] *Id.* at 1093.

[47] *See* Scott v. United of Omaha Life Ins. Co., 934 F 2d 1265 (11th Cir. 1991).

[48] 647 F. Supp. 1397 (D. Mont. 1986), *cited in* ASHELY, *supra* note 6, § 5:03.50.

[49] The court cited both St. Paul Fire & marine Ins. Co. v. Curniskey, 665 P. 2d 223 (Mont. 1983), and Britton v. Farmers Ins. Group, 721 P. 2d 303 (Mont. 1986), which adhere to the good faith rule.

[50] ASHELY, *supra* note 6, at 55.

contract claim." [51] Therefore, as a matter of law, the insurer did not act in bad faith. Common sense required application of the good faith rule.

Conclusion

By recognizing an insurance company's right to challenge debatable claims, the great majority of the American courts help balance the scales of justice between a claimant's right to recover on a policy when a claim is intentionally and wrongfully
 denied and the insurance company's right to question arguable claims. Recognizing good faith as a matter of law is the long-term interest of premium-paying insureds and the financial predictability and stability of insurance companies. And the national trend is clearly to recognize this standard. Insurance companies have a good faith right to be wrong!

[51] *Id.*