

**INSURANCE
BAD FAITH CLAIMS**

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I. WHAT IS INSURANCE AND HOW IS IT REGULATED?

A. INSURANCE DEFINED

An insurance contract is defined by statute in North Carolina at N.C. Gen. Stat. '58-1-10. It provides:

A contract of insurance is an agreement by which the insurer is bound to pay money or its equivalent or to do some act of value to the insured upon, and as an indemnity or reimbursement for the destruction, loss, or injury of something in which the other party has an interest.

Insurance contemplates the shifting of risk from an insured to an insurer. *See Blackwelder v. City of Winston-Salem*, 332 N.C. 319, 420 S.E.2d 432 (1992). There are many statutes, regulations and appellate decisions applicable to insurance contracts which regulate their form, construction and application. Thus, it is important to identify whether a particular contractual arrangement constitutes insurance. Of course one fairly certain way to establish this is if the drafters of the document have anywhere referred to it as insurance or provided that it insures someone or something. Even if the words insurance or insurer are not found in the document, that does not mean that it is not de facto insurance, and thus subject to applicable rules and regulations for such a contract. For example, an agreement among a number of separate legal entities that they will pool their financial resources to absorb claims within the group, although not denominated as insurance, may actually act as insurance since there is an agreement to indemnify and the risk of this agreement is spread among many. *See, e.g.*, N.C. Gen. Stat. '58-23-1 *et. sequa* (Local Government Risk Pool Act). However, if an entity such as a municipality merely sets aside a certain sum of money to protect it against tort claims where it has not joined with other entities to pool this risk it will not be deemed insurance. *See Blackwelder v. City of Winston-Salem, supra.*

The kinds of insurance authorized by the State of North Carolina are generally listed at N.C. Gen. Stat. Section 58-7-15 and includes the following list of types of insurance:

1. Life Insurance
2. Annuities
3. Accident and Health Insurance
4. Fire Insurance
5. Miscellaneous Property Insurance
6. Water Damage Insurance
7. Burglary and Theft Insurance
8. Glass Insurance
9. Boiler and Machinery Insurance
10. Elevator Insurance
11. Animal Insurance
12. Collision Insurance
13. Personal Injury Liability Insurance
14. Property Damage Liability Insurance
15. Workers' Compensation and Employer's Liability Insurance
16. Fidelity and Surety Insurance
17. Credit Insurance

18. Title Insurance
19. Motor Vehicle or Aircraft Insurance
20. Marine Insurance
21. Marine Protection and Indemnity Insurance
22. Miscellaneous Insurance

Obviously, subcategory 22. can serve as a broad catch-all provision which includes types of insurance not previously enumerated in the first 21 categories. A number of pseudo-insurance relationships exist where the Legislature has attempted to define what resembles a warranty and what resembles an insurance contract. *See, e.g., N.C. Gen. Stat. Section 58-1-15* (warranties by manufacturers, distributors or sellers of goods or services); *See N.C. Gen. Stat. Section 58-1-20* (real property warranties); *N.C. Gen. Stat. Section 58-1-25* (motor vehicle service agreement companies); *N.C. Gen. Stat. Section 58-1-30* (home appliance service agreement companies); *N.C. Gen. Stat. Section 58-1-42* (mechanical breakdown service agreements). Compare, *Cincinnati Ins. Co. v. Centech Building Corp.* 286 F.Supp.2d 669 (M.D.N.C. 2003) holding that the provisions of N.C. Gen. Stat. Section 58-63-15 did not apply to a construction surety, finding that surety arrangement did not sufficiently resemble insurance to permit use of North Carolina's Unfair Insurance Practices Statute.

North Carolina insurance contracts are generally governed by Chapter 58 of the North Carolina General Statutes. However, there are a number of other statutory provisions which more specifically address certain types of insurance. For example, Chapter 20 of the General Statutes addresses automobile insurance and to the extent it conflicts with any provisions under Chapter 58, the North Carolina courts have held that the more specific provisions of Chapter 20 govern the more general insurance provisions of Chapter 58. *Odom v. Nationwide Mutual Ins. Co.*, 101 N.C. App. 627, 401 S.E.2d 87, *review denied*, 329 N.C. 499, 47 S.E.2d 539 (1991).

A non-exclusive list of statutory provisions relating to the regulation of certain types of liability insurance policies includes:

- (a) motor vehicle liability insurance policies - N.C. Gen. Stat. '20-279.21
et. sequa.
- (b) liability insurance for rental vehicles - N.C. Gen. Stat. '20-281 through 284;
- (c) insurance protection for taxi operators - N.C. Gen. Stat. '20-280
- (d) commercial general liability coverage (extended reporting endorsement) N.C. Gen. Stat. '58-40-140(a)
- (e) professional liability insurance (extended reporting endorsement) - N.C. Gen. Stat. '58-40-140(a)
- (f) health care provider professional liability insurance - N.C. Gen. Stat. '58-40-140(b)

Policy forms are regulated by the North Carolina Department of Insurance in North Carolina and absent a specific exception presumably any North Carolina liability policies should be approved as to

their wording and content prior to issuance pursuant to N.C. Gen. Stat. Section 58-3-150 and N.C. Gen. Stat. Section 58-41-50 *et. sequa.*

The regulation of insurance is further undertaken by way of regulations. Title 11 of the North Carolina Administrative Code is devoted to insurance regulation. The regulations of Title 11 provide some fine tuning to the statutes. Two chapters of Title 11 that in particular may provide some regulatory input for liability policies are Chapter 4 which deals with consumer services and spends a lot of time on the adjustment of claims, and Chapter 10 which deals with property and casualty coverage.

While generally North Carolina law will be the primary source of regulation as to the content and construction of insurance contracts, occasionally federal laws or regulations may also influence this issue on certain types of coverage. For example, so called ICC endorsements are often issued to commercial auto policies for motor carriers involved in interstate commerce. These policies contain endorsements (or should) which deal with federal insurance requirements and regulations promulgated through the ICC, including a specified endorsement to address liability coverage requirements for certain motor vehicles involved in interstate commerce. See 49 C.F.R. '387.15 (setting forth the language for MCS - 90 an insurance endorsement for compliance with ICC requirements for motor carriers). There has been considerable litigation involving ICC endorsements. Similarly, many state laws are pre-empted by Federal ERISA Laws pertaining to certain accident, health care and life insurance coverages.

B. POLICIES WITH CONNECTIONS TO MORE THAN ONE STATE

From time to time one will confront a policy that is issued to a national corporation which does business in many states, or which is headquartered in another state but which has operations or contact with North Carolina. Such a policy might be procured in another state and sent to the insured corporation in another state, but have some implications for a tort or other claim arising and pending in North Carolina. North Carolina has a statutory provision, N.C. Gen. Stat. '58-3-1 which provides:

All contracts of insurance on property, lives, or interests in this State shall be deemed to be made therein, and all contracts of insurance the applications for which are taken within the State shall be deemed to have been made within this State and are subject to the laws thereof.

Thus according to this statute, while a liability insurance policy may provide that it was issued by an out-of-state insurer to an insured headquartered outside of North Carolina, North Carolina law may well nevertheless control the construction of the if it involves Aproperty, lives, or interests in this State@. See *Collins & Aikman Corp. v. Hartford Accident & Indemnity Co.*, 335 N.C. 91, 436 S.E.2d 243 (1993)(applying North Carolina law to the construction to an umbrella policy issued to an out-of-state insured by an out-of-state insurer for an North Carolina accident).

In fact, in the realm of motor vehicle liability insurance, the courts have on a number of occasions applied North Carolina statutory mandates to liability policies although the policy was issued to an out-of-state corporate insured. See *Hendrickson v. Lee*, 119 N.C. App. 444, 459 S.E.2d 275 (1995) (policy governed by North Carolina law where commercial vehicle was registered and principally garaged in North Carolina pursuant to N.C. Gen. Stat. '20-309); *Martin v. The Continental Insurance Company*, 123 N.C. App. 650, 474 S.E.2d 146 (1996) (applying North Carolina requirements to commercial auto policy where North Carolina had a close connection with the interest insured@)

On the other hand, if a policy is clearly issued to an out-of-state insured for an out-of-state risk, and the only connection with North Carolina is the situs of the accident, then in all likelihood North Carolina will apply the law of the state where the policy was issued or delivered. See e.g., *Fortune Ins. Co. v. Owens*, 351 N.C. 424, 526 S.E.2d 463 (2000) (applying Florida law to auto policy issued in Florida to Florida insureds where accident occurred in North Carolina).

C. CLAIMS OF FIRST PARTIES/INSUREDS FOR BAD FAITH

1. Bad Faith Claims Generally.

Under the heading of “extra-contractual damages” is found a wide spectrum of litigation involving various types of improper conduct of insurance companies. The trend in this country has been to read into each insurance policy an implied covenant of fair dealing with the insured. The breach of this duty may give rise to liability against the insurer for bad faith. Generally speaking, when a claim for bad faith against an insurer involves a party not directly involved with the formation of the insurance contract, or does not directly involve an insurer/insured dispute such a relationship is referred to as a third party claim.

Traditionally, contractual relationships generally did not, in the event of a breach, give rise to any remedies in tort, and the damages available were limited to those in contract. *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (1854). However, North Carolina has moved toward the recognition of certain damages, not traditionally available for the breach of an insurance contract, when specific aggravated conduct is established. No uniform standard applies to all such relationships, but rather North Carolina has developed several different theories of recovery, each requiring separate showings of proof.

First, under the common law, the North Carolina courts have developed a body of precedent relating to liability for wrongful conduct of insurers in third party claims, and have also evolved a body of law relating to wrongful conduct of insurers in first party claims. This liability of an insurer is grounded in the “bad faith” performance of its duties arising under the insurance contract. North Carolina cases have indicated that under certain circumstances, such bad faith can variously give rise to payment of judgments in favor of third parties in excess of policy limits, to payment of punitive damages and perhaps to payment for emotional distress and other damages.

Second, the enactment of North Carolina’s unfair claims practices statute, N. C. Gen. Stat. §58-63-15(11) (formerly §58-54.4(11)) when used in conjunction with North Carolina’s

unfair trade practices statute, N. C. Gen. Stat. §75-1.1, provides a potential recovery for treble damages if certain statutorily proscribed activity is established. Attorney's fees may also be available as an additional remedy in the event of an unfair trade practice.

Given the complexities of the contractual obligations running between insurers and various parties directly and indirectly associated with the insurance contract, counsel occasionally find themselves in difficult circumstances sorting through their obligations.

In all endeavors relating to performance of its insurance contract obligations, a North Carolina insurer has a duty to act in good faith, and may deny claims so long as it is based on an honest disagreement or an innocent mistake. *Lovell v. Nationwide Mutual Ins. Co.*, 108 N.C. App. 416, 424 S.E.2d 181, *affirmed in part, discretionary review improvidently allowed in part*, 334 N.C. 682, 435 S.E.2d 71 (1993) (*per curiam*).

North Carolina is still evolving its so-called bad faith law as it relates to implementation of remedies for breach of duties pursuant to an insurance policy. Generally speaking, there are two basic types of remedies. One is a common law remedy based on tortious conduct accompanying the breach of a contract. The breach must be accompanied by or contain an element of aggravation such as "fraud, malice, such a degree of negligence as indicates a reckless indifference to consequences, oppression, insult, rudeness, caprice willfulness . . ." *Newton v. Standard Fire Ins. Co.*, 291 N.C. 105, 229 S.E.2d 279 (1976). While *Newton, supra*, is something of the grandfather of North Carolina's common law bad faith claims, interestingly enough the court there did not decide specifically whether an insurer's bad faith refusal would trigger the imposition of punitive damages, the heart and soul of a common law bad faith claim.

Most of the case law since then has been from the North Carolina Court of Appeals rather from the North Carolina Supreme Court. One of the leading bad faith cases from the Court of Appeals involving an automobile policy is *Lovell, supra*. In that case, the Court of Appeals upheld a bad faith award based on a delay in tendering med pay limits and linking them to the wrongful death liability claims. The jury awarded \$225,000 in punitive damages on a \$2,000 medical payments claim. The court in that case summarized the right to recover punitive damages for bad faith as follows:

In order to recover punitive damages for the tort of an insurance company's bad faith refusal to settle, the plaintiff must provide (1) A refusal to pay after recognition of a valid claim, (2) bad faith, and (3) aggravating or outrageous conduct.

108 N.C. App. at 420. *See also, Dailey v. Integon General Ins. Corp.*, 75 N.C. App. 387, 331 S.E.2d 148, *discretionary review denied*, 314 N.C. 664, 336 S.E.2d 399 (1985) (homeowners policy); *Robinson v. N.C. Farm Bureau Mutual Ins. Co.*, 86 N.C. App. 44, 356 S.E.2d 392, *discretionary review allowed*, 320 N.C. 633, 360 S.E.2d 93 (1987), *discretionary review dismissed*, 321 N.C. 592, 364 S.E.2d 140 (1988) (commercial fire policy); *U.S. Fire Ins. Co. v. Nationwide Mutual Ins. Co.*, 735 F.Supp. 1320 (E.D.N.C 1990), *affirmed*, 918 F.2d 955 (1990) (auto liability policy) (construing North Carolina law).

Recently, the North Carolina Supreme Court attempted in a case not involving insurance coverage to define the term “good faith”. *Bledsoe v Johnson*, 357 N.C. 133, 579 S.E.2d 379 (2003). The Court observed:

Good faith is an equitable concept premised on honest belief and fair dealings with another. Failure to act in good faith implies that an offending party’s conduct will preclude another person from obtaining a benefit to which that person is entitled.

357 N.C. at 140, 579 S.E.2d 383.

Very recently, the U.S. Supreme Court overturned an award of punitive damages involving bad faith by an automobile insurer in Utah, discussing information that would be relevant to a jury in formulating the amount of the punitive damages to be awarded in the circumstance involving bad faith, and in attempting to fix the Constitutional parameters for the appropriate size of a punitive damages verdict in that circumstance. *See, State Farm Mut. Automobile Ins. Co. v. Campbell*, 538 U.S. 408, 123 S.Ct. 1513, 71 USLW. 4282 (2003).

The second theory of recovery for inappropriate handling of claims by an insurance company is statutorily derived. Rather than seeking punitive damages, this theory of recovery utilizes treble damages and attorneys’ fees as the remedy for inappropriate conduct. At N.C. Gen. Stat. §58-63-15(11) the North Carolina legislature has set forth a statutory list of unfair claims settlement practices. That statute provides:

- (11) Unfair Claim Settlement practices. – Committing or performing with such frequency as to indicate a general business practice of any of the following: Provided, however, that no violation of this subsection shall of itself create any cause of action in favor of any person other than the Commissioner:
 - a. Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;
 - b. Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
 - c. Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
 - d. Refusing to pay claims without conducting a reasonable investigation based upon all available information;
 - e. Failing to affirm or deny coverage of claims within a reasonable time after proof-of-loss statements have been completed;
 - f. Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;

- g. Compelling [the] insured to instate litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insured;
- h. Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled.
- i. Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured;
- j. Making claims payments to insured or beneficiaries not accompanied by [a] statement setting forth the coverage under which the payments are being made;
- 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;
- l. Delaying the investigation or payment of claims by requiring an insured claimant, or the physician, of [or] either, to submit a preliminary claim report and then requiring the subsequent submission of formal proof-of-loss forms, both of which submissions contain substantially the same information;
- 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; and
- n. Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement

In construing the predecessor statute to N.C. Gen. Stat. §58-63-15 (the predecessor was N.C. Gen. Stat. §58-54.4), the North Carolina Supreme Court held in *Pearce v. American Defender Life Ins. Co.*, 316 N.C. 461, 348 S.E.2d 174 (1986), that a violation of the Unfair Claims Handling statute as a matter of law constituted an unfair deceptive trade practice in violation of N.C. Gen. Stat. §75-1.1. Several cases have more recently held that a violation of N.C. Gen. Stat. §58-63.15 (10) is as a matter of law an unfair and deceptive trade practice. *See e.g., Bentley v. N.C. Insurance Guaranty Assoc.*, 107 N.C. App. 1, 418 S.E.2d 705 (1992); *Kron Medical Corp. Collier Cobb & Assoc.*, 107 N.C. App. 331, 420 S.E.2d 192, *discretionary review denied*, 333 N.C. 168, 424 S.E.2d 920 (1992), *reconsideration dismissed*, 333 N.C. 345, 426 S.E.2d 706 (1993).

Recently, what appears to be a landmark holding in North Carolina as to the construction and application of the Unfair Claim Settlement Practices Act, as it relates to the Unfair Trade Practices Act, was rendered in *Gray v. North Carolina Insurance Underwriting Assoc.*, 352 N.C. 61, 529 S.E.2d 676, *rehearing denied*, 352 N.C. 599, 544 S.E.2d 771 (2000). The

court went into great detail in examining the relationship between N.C. Gen. Stat. §58-63-15(11) and N.C. Gen. Stat. §75-1.1. Many points of law were clarified in this sweeping opinion. It held that a violation of a listed prohibited claims practice in §58-63-15(11) constituted a violation of N.C. Gen. Stat. §75-1.1 as a matter of law.

Second, while a number of previous decisions had come down on both sides of the fence as to the requirement of a showing of a “frequency” of violations by the insurance company, the *Gray* decision held that a single violation of N.C. Gen. Stat. §58-63-15(11) is sufficient to establish a violation of N.C. Gen. Stat. §75-1.1, rather than having to show a “pattern or practice”. See also, *Anderson v. Lancaster Aviation, Inc.*, 220 F.Supp.2d 524 529 (M.D.N.C. 2002) (discussing *Gray* decision on requirement of frequency of violations).

Two other important points are made in the decision. Unlike in a common law bad faith claim, a defense of “good faith” is not a bar to a Chapter 75 violation. This is an interesting point of law that seems to obviate the need for relating to the animus or intent of an insurance company in behaving the way it did on a given occasion, so long as it committed a proscribed act. Also, as had been stated in a number of other cases, a determination of whether this type of act is an unfair or deceptive trade practice is a question of law for a court, rather than a question of fact for the jury. In *Gray*, the jury was asked to answer a number of factual issues about certain claims handling practices which provided the basis for the trial court’s ruling that there was an unfair or deceptive trade practice by way of a violation of North Carolina’s unfair claims settlement practices prohibitions. The *Gray* decision is a must read for any prosecution of this type of claim.

More recently, in *Country Club of Johnston Club, Inc. v. United States Fidelity & Guaranty Co.*, 150 N.C. App. 231, 563 S.E.2d 269 (2002), the Court of Appeals addressed an award based on North Carolina’s Unfair Claims Handling statute as implemented through North Carolina’s unfair trade practices statute. In that case, as in *Gray*, the jury was asked to answer a number of interrogatories pertaining to potential violations of North Carolina’s claims handling statute. The jury answered a number of these interrogatories in the affirmative, indicating that the claims handling statute had been violated. Based on this finding by the jury, the trial court trebled the compensatory damages award against the insurer, in that case involving a commercial general liability policy. The Court of Appeals concluded the trial court correctly awarded trebled damages, attorneys’ fees and costs pursuant to N.C. Gen. Stat. §75-1.1. 150 N.C. App. at 238, 563 S.E.2d at 274. *Cincinnati Ins. Co. v. Centech Building Corp*, 286 F.Supp.2d 669 (M.D.N.C. 2003) (discussing *Country Club* decision, acknowledging that no violation of Section 58-63-15 is needed to establish violation of Section 75-1.1).

In *Westchester Fire Ins. Co. v. Johnson*, 221 F.Supp. 2d 637 (M.D.N.C. 2002), aff’d in part vacated in part on other grounds, 5. Fed. Appx. 111 (2001) (unpublished decision) the Middle District of North Carolina, agreed in *dicta*, that a violation of Section 58-63-15(11) under subsections (a), (l), and (m) would all constitute violations of Section 75-1.1 without establishing any frequency requirement for violations of those subsections. However, in that case the Court found that under the specific facts presented the insured did not establish violations under subsections (a), (l), or (m) of Section 58-63-15(11). That case involved a claim for loss of business income under a policy insuring a shopping center. A similar result was reached in *Central Carolina Bank & Trust Co. v. Security Life of Denver Ins. Co.*, 247 F.Supp.2d 791 (M.D.N.C.

2003), where the Court declined to find statutory violations in the absence of immoral unethical or unscrupulous behavior, and seems to be somewhat at odds with *Gray, supra*.

In *Cullen vs Valley Forge Life Insurance Company*, 161 N.C. Ap. 570, 589 S.E. 2d 423 (2003), rev. denied, 598 S.E. 2d 138 (2004), the North Carolina Court of Appeals held that in determining whether an insurance company was liable for unfair and deceptive trade practices relating to a life insurance policy, the Court held that an insured need not show a reliance on an unfair or deceptive trade practice by the insured as to any misrepresentation, in order to trigger the statutory provisions of N.C. Gen. Stat. Section 75-1.1. The Court noted that “the focus is on the insurance company, not the effect on the policyholder.” The Court summarized that “actual reliance [by the insured] is not a factor, and upheld an award of treble damages against a life insurance company for deceptive communications with its insured.

2. Cases Involving UM/UIM Coverage.

Several North Carolina decisions have looked at bad faith and/or unfair trade practices claims in the context of uninsured/underinsured motorist coverage. In *Miller v. Nationwide Mutual Ins. Co.*, 112 N.C. App. 295, 435 S.E.2d 537, *discretionary review denied*, 335 N.C. 770, 442 S.E.2d 519 (1993), the Court of Appeals reviewed a dismissal of bad faith claims and statutory unfair claims handling claims in a case involving underinsured motorist coverage. First, the court held that a release that left open claims “arising out of . . . [UIM insurer’s] refusal to pay said purported additional UIM coverage as demanded by . . . [claimant]”, did not bar the subsequent bad faith claim. 112 N.C. App. at 300-301. The claimant could go forward with UIM bad faith claims even though the claimant had previously settled some of the claims using a limited release. In finding that the claimant was a first-party insured and that sufficient facts were alleged to reverse a Rule 12(b)(6) dismissal as to bad faith and unfair claims handling practices claims, the court reasoned as follows:

Based on the allegations in plaintiff’s complaint as set forth above, we conclude that plaintiff has sufficiently alleged a tortious act accompanied by some element of aggravation. Plaintiff alleged that defendant breached its duty of good faith in refusing, without reason, to pay plaintiff the full UIM coverage due under the Miller policy and in refusing to effectuate a prompt, fair and equitable settlement of plaintiff’s claim when liability was clear. Plaintiff specifically alleged that in refusing to pay sums due plaintiff under the Miller policy, defendant first claimed not to have sufficient information to determine the extent of plaintiff’s damages, but that when plaintiff provided defendant with substantial additional documentation, defendant continued to refuse payment. Plaintiff alleged further that defendant withheld payment of \$150,000 in remaining funds it acknowledged were due plaintiff in an effort to coerce plaintiff to relinquish his claim for an additional \$100,000. Plaintiff also alleged that defendant failed to cite any case law or statutory authority to support its refusal to pay plaintiff, and that defendant has adopted an “across-the-board” policy and practice in the handling of its first-party insured UIM claims to uniformly contest, and refuse to pay UIM claims which involve a “stacking” of UIM coverages, in total disregard of the applicable policy provisions. These allegations of plaintiff’s complaint, if proven, are sufficient to support an award of damages, including punitive damages, based upon a bad faith refusal to pay

plaintiff's claim to the extent that such claim relates to or arises out of defendant's alleged bad faith refusal to pay plaintiff the UIM coverage for the second of the two automobiles insured under the Miller policy.

112 N.C. App. at pages 306-307.

A key legal finding in the *Miller* case which really opened up the area of bad faith in many respects to claimants who are Class II insureds, is that a UM/UIM claim is deemed to be a first party rather than a third party claim for bad faith. The remedies available for third party claims appear to be more narrowly proscribed than for first party claims.

In a second case, *Braddy v. Nationwide Mutual Liability Ins. Co.*, 122 N.C. App. 432, 470 S.E.2d 820, *discretionary review denied*, 343 N.C. 749, 473 S.E.2d 610 (1996), the Court of Appeals held that where the claimant had both a claim for recovery pursuant to an underinsured motorist claim and a separate claim for bad faith refusal to settle and request for punitive damages, the trial court properly bifurcated the trial. Trying first the personal injury action, and later the bad faith action was an appropriate way to proceed. It appeared from the opinion in some respects that the claimant was attempting to force the UIM carrier to appear in its own name, since there were claims made directly against it for bad faith, rather than to appear in the tort based underlying auto claim in the name of the tort-feasor, as it is normally permitted to do pursuant to N.C. Gen. Stat. §20-279.21(b)(4). It appears the Court of Appeals did not want to take away the UIM insurer's right to defend the personal injury claim in its capacity as an unnamed defendant.

In a third case, *Murray v. Nationwide Mutual Ins. Co.*, 123 N.C. App. 1, 472 S.E.2d 358 (1996), *discretionary review denied*, 345 N.C. 344, 483 S.E.2d 172 (1997), the court looked at both first party claims involving underinsured motorist coverage and third party claims involving liability coverage, all arising out of an automobile accident. As to the first party claims involving underinsured motorist coverage, the Court of Appeals reversed the summary judgment against the claimant on claims for punitive damages pursuant to common law bad faith law, as well as for unfair and deceptive trade practices based on violation of the Unfair Claims Handling statute, N.C. Gen. Stat. §58-63-15(11). As to the claim for unfair and deceptive trade practices, the court indicated that evidence of negligence, good faith or lack of intent are not defenses to such an action. 123 N.C. App. at 10. The court found that the listed conduct in N.C. Gen. Stat. §58-63-15(11) operates as per se incidents of unfair and deceptive trade practices under N.C. Gen. Stat. §75-1.1. *Id.* The court further found that Chapter 75-1.1 is a remedy "in the nature of a private action" for violation of the conduct listed in §58-63-15(11). *Id.* Based on the court's review of the facts in that case, there was sufficient evidence to go forward, and summary judgment was reversed since the claimant had made out "his prima facie case of a §58-63-15(11) violation". *Id.* at 11. As to the bad faith claim for punitive damages based on a tortious breach of contract, the court also reversed summary judgment in favor of the UIM insurer. The court held that there was sufficient evidence of aggravating conduct present, based on the UIM insurer's failure to pay promptly and reasonably under the circumstances "once liability had become reasonably clear." 123 N.C. App. at 18-19.

In a fourth case, *Vasquez v. Allstate Ins. Co.*, 137 N.C. App. 741, 529 S.E.2d 480 (2000), the court addressed issues interesting both from a procedural and from a legal perspective. At the trial court level there was a tri-furcated trial. First, the trial of the underlying wrongful death

claim was litigated and a jury entered a verdict in favor of the estate. Second, phase two involved a trial where the jury answered special written interrogatories pertaining to unfair claims handling practices that would give rise to a claim for unfair and deceptive trade practices. The jury found that the UM insurer had “failed to adjust the plaintiff’s loss fairly, follow its own standards, act reasonably in communications, conduct a reasonable investigation and . . . effect a fair settlement in good faith.” 137 N.C. App. at 743. In the third phase, the jury was asked to consider the plaintiff’s claim for punitive damages based on a bad faith refusal of the UM insurer to settle. The jurors ruled against the plaintiff-insured on this phase. Thereafter, in a very interesting and creative process, the trial court determined that the three jury awards were mutually inconsistent and put the plaintiff to an election of remedies. *Id* at 743. The plaintiff elected the remedy which allowed for treble damages, expert witness fees, and attorneys’ fees. On appeal, the Court of Appeals held that the UM insurer could not avoid extra contractual liability by first offering to pay the applicable coverage after a jury determination of liability for the claim. Further the court affirmed the right of a claimant to elect his remedy between tortious breach of contract or unfair trade practices. Additionally, the court upheld the trial court’s instruction to the jury that the UM insurer had not paid the policy amount at the time of trial. The court held that this information was “necessary” for the jury. 137 N.C. App. at 746. The court further upheld the award of attorneys’ fees in addition to treble damages. This award of attorneys’ fees is a good reminder that in cases where an award of attorneys’ fees may be triggered pursuant to N.C. Gen. Stat. §75-16.1, that a good idea would be to keep time records. That way an affidavit can be subsequently generated with precision to set forth the time spent on the case, in the event the trial court judge is inclined to award attorneys’ fees.

3. Cases Involving Property Losses.

First party claims arise when an insured seeks direct payment from an insurer for a loss. In that instance, the payment is intended to go directly to the insured, rather than to an injured or damaged third party. The seminal case in this area is *Newton v. Standard Fire Insurance Company*, 291 N.C. 105, 229 S.E.2d 297 (1976). In that action, the plaintiff sought to recover for a theft claim not only for the coverage which the insured believed was due from its insurer, but also for punitive damages based on an alleged bad faith refusal of the insurer to pay a valid claim. The opinion affirmed a Rule 12(b)(6) dismissal of the punitive damage claim. The court held that the plaintiff’s allegation that the insurer knew the plaintiff was in precarious financial shape did not give rise to bad faith or show an unjustified refusal to settle. 291 N.C. at 115, 229 S.E.2d at 303. The court declined to decide whether “a bad faith refusal of the insurer to pay a valid claim” would give rise to punitive damages. *Id.*

However, the Court in *Newton* then discussed at some length the possible parameters for a bad faith action. The court observed that “Had plaintiff claimed that after due investigation by defendant it was determined that the claim was valid and defendant nevertheless refused to pay, or the defendant refused to make any investigation at all, and that defendant’s refusals were in bad faith with an intent to cause further damage to plaintiff, a different question would be presented.” 291 N.C. at 115-116, 229 S.E.2d at 303. This statement certainly leaves open the possibility that the North Carolina Supreme Court would consider a bad faith action if there was tortuous conduct “accompanied by either fraudulent misrepresentation or any other recognizable tortuous behavior.” 291 N.C. at 114, 229 S.E.2d at 302.

The court then identified the competing public policy considerations involved in determining whether punitive damages would be an appropriate remedy for alleged insurance bad faith. On the one hand, the court noted that “to create exposure... [for liabilities beyond those called for in the insurance contract] except for the most extreme circumstances would, we are certain, be detrimental to the consuming public whose insurance premiums would surely be increased to cover them.” 291 N.C. at 116, 229 S.E.2d at 303. The court noted that on the other hand “because of the great disparity of financial resources which generally exists between insurer and insured and the fact that insurance companies, like common carriers and utilities, are regulated and clearly affected with a public interest, we recognize the wisdom of a rule which would deter refusals on the part of insurers to pay valid claims when the refusals are both unjustified and in bad faith.” The court then concluded by indicating that “We are not called upon here to adopt or reject such a rule.” *Id.*, 229 S.E.2d at 303-304.

The North Carolina Supreme Court did not again formally address the issue of punitive damages for alleged common law bad faith in first party insurance claims. *Cf.*, *Pierce v. American Defender Life Insurance Company*, 316 N.C. 461, 343 S.E.2d 174 (1986) (reviewing viability of Unfair Trade Practices claim under Chapter 75).

The North Carolina Court of Appeals then sailed into uncharted waters with only the *dicta* of the *Newton* decision as a guide, and has established a considerable body of law pertaining to bad faith claims for punitive damages on first party claims. The case venturing the furthest in this regard is *Dailey v. Integon*, which has twice been before the Court of Appeals. In that action, the trial court originally dismissed a claim for punitive damages for failure to make payment of a fire loss on a house pursuant to Rule 12(b)(6), 57 N.C. App. 346, 291 S.E.2d 331 (1982) (hereinafter “*Dailey I*”). The plaintiff there alleged that the defendant insurer refused to settle in good faith, and that the conduct of the insurer was willful, oppressive and malicious with intent to forestall the plaintiff for a sufficient period of time to bring financial pressure to force a favorable settlement. The Court of Appeals reversed the dismissal, indicating that in order to satisfy the requirements of pleading for recovery for a tortious act, there must be specificity and “some element of aggravation.” The court held that the pleading in that case satisfied such requirements and reversed the trial court’s dismissal. 57 N.C. App. at 350, 291 S.E.2d at 333.

The *Dailey* case was subsequently tried and judgment was entered against the insurer for compensatory damages based on the breach of the insurer’s obligation to pay damages for a house fire. Additionally, the jury awarded \$20,000 in punitive damages against an adjuster who allegedly approached neighbors of the insured suggesting that the insured was guilty of arson. Finally, the sum of \$100,000 in punitive damages was awarded by the jury for the insurer’s wrongful failure to settle in good faith. The trial court granted a J.N.O.V. on the punitive damages and also entered a directed verdict against the plaintiff on a claim for intentional infliction of emotional distress. 75 N.C. App. 387, 331 S.E.2d 148, *disc. rev. denied*, 314 N.C. 664, 336 S.E.2d 399 (1985) (hereinafter “*Dailey II*”). In *Dailey II*, the court held that bad faith in paying a first party claim could arise due to the failure to pay which was not otherwise excused by any provision in the policy. While the court acknowledged that an “honest disagreement” or “innocent mistake” would not give rise to a bad faith claim, if there was sufficient evidence of malice, oppression, willfulness and reckless indifference to consequences, then a bad faith action would be appropriate. The court reviewed the evidence presented at trial in that action and concluded that there was a sufficient showing of bad faith to support an award of punitive

damages and reversed the trial court's J.N.O.V. on that issue. In *Dailey II*, the Court of Appeals squarely addressed the several issues left unresolved by the Supreme Court in *Newton*, and held that a judgment against an insurer for punitive damages would be appropriate upon a showing of bad faith.

In *Payne v. N. C. Farm Bureau Mutual Insurance Company*, 67 N.C. App. 692, 313 S.E.2d 912 (1984), the Court of Appeals, in a decision rendered between its decisions in *Dailey I* and *Dailey II*, held that allegations in the complaint that a refusal to pay a theft claim, including allegations of fraud, should withstand a Rule 12(b)(6) motion on the plaintiff's claim for punitive damages based on a bad faith refusal to settle.

Since *Dailey II*, the North Carolina Court of Appeals has on a case by case basis reviewed the allegations involved to determine if there was sufficient basis to support an action for bad faith on a first party claim. Thus, in *Robinson v. N. C. Farm Bureau Mutual Insurance Company*, 86 N.C. App. 44, 356 S.E.2d 392, *pet. for disc. rev. improvidently allowed*, 321 N.C. 592, 364 S.E.2d 140 (1987), the court held that in a claim for fire damage, the fact that the insurance company eventually offered to pay its policy limits would not in and of itself bar a claim for punitive damages if the plaintiff could show that the claim should have been paid promptly and in full, there was no basis to deny the claim, the refusal was made in bad faith, and the insurer's actions were designed solely to force the plaintiff to go through independent appraisal to receive a full payment. Such allegations were sufficient in that action, if supported by the evidence, to allow the punitive damage issue to go to the jury. Bad faith would not be precluded even though the insurer eventually paid the claim. In that case a summary judgment against the insured was reversed, and the case remanded for a new trial.

In *McMillan v. State Farm Fire and Casualty Company*, 93 N.C. App. 748, 379 S.E.2d 88, *pet. for disc. rev. denied*, 325 N.C. 272, 384 S.E.2d 516 (1989), the Court of Appeals affirmed a summary judgment in favor of an insurer on a claim for alleged bad faith refusal to make payment on a fire damage claim and for requiring plaintiff to go through an appraisal process before payment. In that action, the insured and the insurer had a wide disparity in their respective evaluations of the damages, and the insurer thereafter pursuant to a policy provision, demanded an appraisal. The appraisal was completed and an amount of loss was determined by an independent umpire. The insurer thereafter offered the appraisal amount which the plaintiff declined to accept. The court there held that there was no evidence of fraud, mistake, duress or other impeaching circumstances in the appraisal process and award, and further found that the allegedly unreasonable actions of the insurer did "not rise to the level of aggravated conduct" as was found in *Dailey II*. 93 N.C. App. at 752, 379 S.E.2d at 90.

In *Smith v. Nationwide Mutual Fire Insurance Company*, 96 N.C. App. 215, 385 S.E.2d 152 (1989), the Court of Appeals reversed a Rule 12(b)(6) dismissal of plaintiff's claim for punitive damages based on an alleged failure to settle a property damage claim on the plaintiff's mobile home. The court held that while allegations alleging that the insurer has violated North Carolina's unfair claims practice statute would not alone suffice to survive a dismissal pursuant to Rule 12(b)(6), if there were sufficient underlying facts alleged to establish aggravated and oppressive tortious conduct, such a complaint should not be dismissed. In that action, the plaintiff pleaded a number of activities on the part of the insurer which were specifically referenced as violations of the unfair claims practice statute.

It appears that the North Carolina Court of Appeals will closely scrutinize the plaintiff's evidence at the summary judgment stage, and if evidence is not in the record to support allegations of bad faith, a summary judgment will be affirmed. Thus, in *Seay v. Allstate Insurance Company*, 59 N.C. App. 220, 296 S.E.2d 30 (1982), the court upheld a summary judgment based on allegations which were made "upon information and belief," and thus did not meet the requirements of Rule 56(e) for affidavits made on personal knowledge. Similarly, in *Olive v. Great American Insurance Company*, 76 N.C. App. 180, 333 S.E.2d 41, *disc. rev. denied*, 314 N.C. 668, 336 S.E.2d 400 (1985), the court upheld a summary judgment against the insured on its claim for bad faith in that the evidence showed no issue of material fact as to the insurer's bad faith. It would seem at the summary judgment stage a plaintiff should be prepared to come forward with some evidence in support of bad faith which consists of more than mere speculation or suspicion. *C.f.*, *Evans v. USAA*, 142 N.C. App. 18, 541 S.E.2d 782, *pet. denied*, 353 N.C. 371, 547 S.E.2d 810 (2001) (addressing discoverability of homeowner insurer's claims file in a bad faith action).

Finally, several opinions have recently looked at property damage claims in the context of Chapter 75 claims. *See, Gray v. N.C. Ins. Underwriting Assn., supra; High Country Arts and Craft Guild v. Hartford*, 126 F.3d 629 (4th Cir. 1997) (construing N.C. law, affirming Unfair Trade Practices Judgment).

In an interesting recent development, the Fourth Circuit has held that there may be a Federal Common Law Claim for breach of the covenant of good faith and fair dealing as it relates to flood insurance under the National Flood Insurance Program. *See, Battle v. Seibels Bruce Insurance*, 288 F.3d 596 (4th Cir. 2002).

4. Cases Involving Health Insurance

North Carolina provides a considerable number of regulations pertaining to health insurance and benefits through insurance. *See, e.g.*, N.C. Gen. Stat. §58-50-1 *et sequa* (General Accident and Health Insurance Regulations), N.C. Gen. Stat. §58-51-1 *et sequa* (nature of policies), 11 N.C.A.C. Chapters 4 (Consumer Services Division) and Chapter 12 (Life and Health Division). There are numerous North Carolina statutes and regulations that impact health and disability benefits. However, these cases are extremely complicated, in large part due to possible federal preemption through the Employee Retirement Income Security Act of 1974 (commonly referred to as "ERISA"). *See* 29 U.S.C. §1001, *et sequa*. The North Carolina Courts have absolutely recognized this preemption by the Federal Courts for employee benefit plans providing health or other insurance benefits through an "employee benefit plan". *See, e.g. Voelske v. Mid South Insurance Company*, 154 N.C. App. 704, 572 S.E. 2d, 841 (2002). Federal preemption in the 4th Circuit means that only federal remedies available through ERISA will be available when making a claim for the benefits that the insured believes are provided for in the benefit plan. Non-ERISA state law remedies are apparently not available through the application of ERISA law. *See, Massachusetts Mutual Life Insurance Co. v. Russell*, 473 U.S. 134, 105 S.Ct. 3085, 87 L.Ed 2d 96 (1985). Claims for attorney's fees may be awarded within the discretion of the court. *See, 29 U.S.C. §1132(g)*. These claims are quite complicated with a heavy overlay of Federal Law and regulation. Most of these employee benefit plans provide that prior to making a legal claim through the courts, that the administrative remedies of internal appeal (usually within set deadlines) must be first exhausted. Thus, often a potential client may not even reach the attorney's office before a deadline for an internal appeal process

has already run. Additionally, it is often difficult to obtain the actual language of the employee benefit plan, although under Federal Law there is an absolute duty to provide that in a prompt fashion.

Thus, one should proceed into the thicket of claims involving health or disability benefits, which might involve an employee benefit plan covered by ERISA, with the greatest of care. While there are a number of policies that are not preempted through ERISA, the scope of preemption is pronounced. See, 29 U.S.C. §1144.

5. Cases Involving Life Insurance

There are a host of statutory and regulatory provisions addressing, content, marketing, advertising, and sale of various life insurance products. See, e.g., N.C. Gen. Stat. §58-58-1 *et sequa*; 11 N.C.A.C. Chapters 4 and 12.

In N.C. Gen. Stat. §58-63-1 *et sequa*, North Carolina provides that unfair methods of competition or unfair and deceptive acts or practices are prohibited. At N.C. Gen. Stat. §58-63-15 a number of specific unfair or deceptive activities are enumerated, including categories of activity which squarely fall within the ambit of life insurance business. These include misrepresentations and false advertising, unfair discrimination, improper rebates, and unfair settlement practices. These violations, in the context of life insurance as a matter of law constitute unfair or deceptive trade practices pursuant to N.C. Gen. Stat. §75-1.1, allowing recovery for treble damages and attorneys fees. See *Pearce v. American Defender Life Ins. Co.*, 316 N.C. 461, 343 S.E.2d 174 (1986). Some claims practices involving life, accident, and health insurance are further enumerated by way of North Carolina's insurance regulations (assuming they are not otherwise policies pre-empted by ERISA, see discussion *supra*. See 11 NCAC 4.0319, which enumerates "prima facie" violations of N.C. Gen. Stat. §58-63-15(11), although not all the categories of conduct stated therein appear to apply to life insurance.

In *Pearce v. American Defender Life Ins. Co.*, *supra*, the North Carolina Supreme Court held that was sufficient evidence to withstand a motion for a directed verdict at trial on the plaintiff's claim for statutory unfair trade practice claims based on a violation of the predecessor statute to N.C. Gen. Stat. §58-63-15(11). That case involved the denial of life insurance benefits based on the failure to pay benefits under an accidental death rider. In contrast, in *Central Carolina Bank & Trust Co. v. Security Life of Denver Ins. Co.*, 247 F.Supp.2d 791 (M.D.N.C. 2003), the Federal Court held that summary judgment was appropriate for claims against a life insurer that had allegedly engaged in unfair and deceptive business practices, when it did not pay all of the coverage the plaintiff alleged was due. The Court found that a legitimate legal dispute between the insured and the life insurer as to the legal effect of a defective premium notice did not rise to the level of statutory violations of Section 58-63-15 (11).

More recently, in *Cullen v. Valley Forge Life Insurance Co.*, 161 N.C. App. 570, 589, S.E.2d 423, (2003) review denied, 598 S.E.2d 138 (2004), the court upheld a finding of liability for unfair trade practices by a life insurer pursuant to N.C. Gen. Stat. §75-16, based on

representations contained in correspondence from the life insurer about the nature of the coverage. The court held that the misrepresentations did not need to be established as having actually deceived the insured, so long as they were made by the insurance company with the intent to deceive the insured.

More recently in *Hunter v. Guardian Life Insurance Company of America*, 162 N.C. App. 477, 593 S.E. 2d 595 (2004), the court held that an insured had sufficiently pleaded claims for constructive fraud against a life insurance company based on the alleged activity by a life insurance company and agent for fraudulent concealment of material facts when using financial illustrations to project out the annual premiums over time, a so-called “vanishing premium obligation”. The cause of action for “constructive fraud” was found to be based on a fiduciary relationship, rather than specific misrepresentations, and the court found that in that action there were sufficient pleading to survive the insurer’s Rule 12(b)(6) motion. The court further found that claims for negligent misrepresentation in unfair and deceptive trade practices also were sufficiently alleged to survive a 12(b)(6) motion.

6. Cases Involving Workers’ Compensation Bad Faith Issues.

The North Carolina case law on bad faith as it relates to the handling of workers’ compensation claims is still in the developmental stage. However, it appears for the most part that such issues will be left with the Industrial Commission and not the subject of civil tort actions in the general courts of justice. In *Johnson v. First Union Corp.*, 131 N.C. App. 142, 504 S.E.2d 808, *rev. allowed* by 349 N.C. 529, 526 S.E.2d 175 (1998), *rev. improvidently allowed* by 351 N.C. 339, 525 S.E.2d 171, and *reh’g denied* by 351 N.C. 648, 543 S.E.2d 870 (2000) the North Carolina Court of Appeals held that the North Carolina general statutes provided a “comprehensive regulatory scheme” for the handling of claims in that area which involves work related injuries. While the Court did not address the precise remedies which would be available through the Industrial Commission for the alleged bad faith handling of a workers’ compensation claim (their suit was brought against a number of defendants including the employer and the workers’ compensation insurer). Thus, although there were allegations of fraudulent activity, the Court found that this was best addressed in the Industrial Commission.

Similarly, in *Groves v. Travelers Insurance Company*, 139 N.C. App. 795, 535 S.E.2d 105 (2000), the Court of Appeals likewise held that all claims involving bad faith and unfair and deceptive trade practices relating to a workers’ compensation claim would be exclusively within the jurisdiction of the Industrial Commission pursuant to the North Carolina Workers’ Compensation Act. Interestingly enough, there the majority opinion, however, allowed a claim for intentional infliction of emotional distress by the claims handlers to proceed. A dissenting opinion finding that there was insufficient evidence in the record of intentional infliction of emotional distress was adopted by the Supreme Court in reversing that portion of the Court of Appeals Opinion. 354 N.C. 206, 552 S.E.2d 141 (2001) (*per curiam*). Thus, the Supreme Court did not rule directly on whether people involved in the claims process could be sued for intentional infliction of emotional distress, but reversed the Court of Appeals Opinion on the sufficiency of evidence of emotional distress in that particular case.

Thereafter, in *Deem v. Treadaway & Sons Painting and Wallcovering, Inc.*, 142 N.C. App. 472, 543 S.E.2d 209, *rev. denied* by 354 N.C. 216, 553 S.E.2d 911 (2001) the Court held that even a claim for intentional infliction of emotional distress would be barred in Superior Court, holding that all such claims were the exclusive province of the Industrial Commission. Thus, it appears that the *Deem* Opinion and the *Groves* Opinion are not quite on all fours on this issue.

More recently, in *Riley v. Debaer*, 149 N.C. App. 520, 562 S.E.2d 69 (2002) the North Carolina Court of Appeals held that no negligent infliction of emotional distress claims could be brought against two rehabilitation employees (presumably hired as independent contractors through the employer/insurer) for their mishandling of a claimant with a workers' compensation claim. That decision contained a dissenting opinion arguing that claims against the rehabilitation employees were far enough removed from the actual workers' compensation claim to be outside the exclusive jurisdiction of the Industrial Commission. However, on appeal, the North Carolina Supreme Court adopted the majority opinion. 356 N.C. 426, 571 S.E.2d 587 (2002) (*per curiam*).

Finally, it should be recalled that at a minimum it would appear that there are statutory protections for certain claims handling malfeasance such as a 10% penalty for late payment or for attorneys' fees. See e.g. *Carroll v. Living Centers Southeast Inc.*, 157 N.C. App. 116, 577 S.E.2d 925, *pet. denied*, 357 N.C. 249, 582 S.E.2d 29 (2003); *Chavis v. Thetford Property Management, Inc.*, 155 N.C. App. 769, 573 S.E.2d 769 (2003) (awarding fees); *Palmer v. Jackson*, 157 N.C. App. 625, 579 S.E.2d 901 (2003) *pet. For dis. Rev. improvidently allowed*, 358 N.C. s7s, 595 W.E.2d 145 (2004) (discussion of how attorneys' fees may be calculated); *Tucker v. Workable Company, Inc.*, 129 N.C. App. 695, 501 S.E.2d 360 (1998); *Hieb v. Howell's Child Care Center, Inc.*, 123 N.C. App. 161, 472 S.E.2d 208 (1996).

D. Cases Involving Bad Faith and Liability Coverage.

1. Introduction

Generally speaking, a liability policy will contain two important duties to an insured. The first of these is the duty to provide a defense to the insured in the event of litigation, and the second is to indemnify the insured up to a stated limit of coverage.

2. The Breach of the Duty to Provide a Defense.

A pair of North Carolina Supreme Court decisions address these two distinct duties. In *Waste Management of Carolinas, Inc. v. Peerless Insurance Company*, 315 N.C. 688, 340 S.E.2d 374, *rehearing denied*, 316 N.C. 386, 346 S.E.2d 134 (1986), the court set forth the extent of the insurer's duty to provide a defense when faced with litigation initiated against the insured. The court there held that "[a]n insurer's duty to defend is ordinarily measured by the facts as alleged in the pleadings; its duty to pay is measured by the facts ultimately determined at trial. When the pleadings state facts demonstrating that the alleged injury is covered by the policy, then the insurer has a duty to defend, whether or not the insured is ultimately liable." 315 N.C. at 691,

340 S.E.2d at 377. The case further suggests that even if the pleadings allege facts indicating that the event in question is not covered, the insurer would still have a duty to defend if it had knowledge that the true facts of the event were otherwise, and would be covered if accurately pleaded. *Id.*

More recently, in *Brown v. Lumbermen's Mutual Casualty Company*, 326 N.C. 387, 390 S.E.2d 150 (1990), the court ruled that the duty to defend may not be extinguished even after the payment of policy limits, depending on the language contained in the insurance policy, relative to the duty to defend.

The *Waste Management* case clearly indicates that the duty to defend is broader than the duty to indemnify, so that it is readily conceivable that the situation may arise where an insurer should properly be providing a defense, hopefully under a reservation of rights or a non-waiver agreement signed by the insured, and yet the insurer might not have a duty to pay the judgment ultimately rendered.

3. Breach of the Duty to Settle.

Insureds generally would like to have attorneys provided for them at the expense of an insurance company, and also from time to time will be desirous of having (and sometimes will demand) an insurance company settle a claim within the policy limits prior to a trial and verdict. Assuming that a given insured has such rights in a given case, and these duties are breached by the insurer, the question arises as to the remedies, if any, available under North Carolina law.

The North Carolina courts have addressed the duties of an insurer in this situation on a number of occasions. An early leading case in this area of the law is *Wynnewood Lumber Company v. The Travelers Insurance Company*, 173 N.C. 269, 91 S.E. 946 (1917). In that case, the court held that the right to settle by an insurer "must be exercised in good faith and without any wrongful or fraudulent purpose.... The insurer is liable when it assumes the duty of defending a suit and negligently fails to discharge such duty. The insurer is also liable if it exercises the exclusive power of settlement in bad faith, or for purposes of fraud, to the injury of the insured." 173 N.C. at 271, 91 S.E. at 947.

While the Court in *Wynnewood* somewhat confusingly mentions both a standard involving "good faith" and one involving "negligence," later decisions seem to adopt the standard of good faith. Thus, in *Alford v. Insurance Company*, 248 N.C. 224, 103 S.E.2d 8 (1958), the North Carolina Supreme Court adopted the language "diligently and in good faith" in describing the obligation of an insurer in effecting settlements within policy limits. The court noted that "courts have consistently held that insurer owes a duty to its insured to act diligently and in good faith in effecting settlements within policy limits, and if necessary to accomplish that purpose, to pay the full amount of the policy. Liability has been repeatedly imposed upon insurance companies because of their failure to act diligently and in good faith in effectuating settlements with claimants." 248 N.C. at 229, 103 S.E.2d at 12.

Similarly, in *Conner v. Insurance Company*, 265 N.C. 188, 143 S.E.2d 98 (1965), the North Carolina Supreme Court again used the language “diligently and in good faith,” this time in its description of the duty owed by the insurer to the insured when the insurer undertook the defense of the action, rather than as to the duty to settle. *See also, Henry v. Nationwide Ins. Co.*, 139 F. Supp. 806 (E.D.N.C. 1956) (in construing North Carolina law, holding that under *Wynnewood*, North Carolina has adopted the standard of bad faith rather than negligence in cases involving an insurer’s rejection of a settlement offer); *Abernethy v. Utica Mutual Ins. Co.*, 373 F.2d 565 (4th Cir. 1967) (same). *See generally*, Comment, *North Carolina’s Cautious Approach Toward the Imposition of Extracontract Liability on Insurers For Bad Faith*, 21 Wake Forest L. Rev. 957, 965 (1986).

The remedy for failure to properly settle or defend a third party claim seems to be payment of the entire judgment, even if it exceeds the policy limits involved. In *Thomas v. Insurance Company*, 277 N.C. 329, 177 S.E.2d 286 (1970), the court addressed allegations that an insurer improperly failed to settle a claim within the policy limits. There, while the court affirmed a directed verdict in favor of the defendant insurer, there is some language which suggests that the remedy upon a proper showing by the plaintiff would be payment of the entire judgment, including that portion above the policy limits.

A similar result was reached in *Coca Cola Bottling Company of Asheville v. Maryland Casualty Company*, 325 F.Supp. 204 (W.D.N.C. 1971), where the court confronted a case with a large jury verdict from the underlying tort claim, which was well in excess of those generally seen in that county for that type of injury. While the court declined to find liability for a bad faith refusal to settle, it indicated that the remedy upon a showing of a failure to settle in good faith would include a judgment against the insurer for the verdict, even if beyond the policy limits.

It appears that there will be a cause of action against the insurer, even where the insured has not first itself paid the judgment in excess of the coverage limits or even if it is insolvent. *See, Gray v. Grain Dealers*, 871 F.2d 1128 (D.C. Cir. 1989) (construing N.C. law); *State Auto Mutual Ins. Co. v. York*, 104 F.2d 730, cert. denied, 308 U.S. 591 (4th Cir. 1939) (construing North Carolina law). *See generally*, Annot., *Insured’s Payment of Excess Judgment, or a Portion thereof, as Prerequisite of Recovery against Liability Insurer for Wrongful Failure to Settle Claim against Insured*, 63 A.L.R.3d 627 (1975).

In *Wilson v. State Farm Mutual Auto Insurance Company*, 327 N.C. 419, 394 S.E.2d 807 (1990), the North Carolina Supreme Court addressed whether a third party could be heard to complain about the failure of an auto insurer to provide a defense to its insured, a tort-feasor. The Court there declined to allow the third party claimant to pursue a direct claim against the insurer for wrongfully refusing to defend the tort-feasor or to wrongfully refuse to settle the claim. However, the Court did note by way of contrast:

This is not the same as a case in which a carrier wrongfully refuses to defend its insured or wrongfully refuses to settle the claim and damages are recovered

against the insured in excess of the coverage. In such a case the insured has been damaged and has a claim against the insurer. *Thomas v. Insurance Co.*, 277 N.C. 329, 177 S.E.2d 286 (1970); *Lumber Co. v. Insurance Co.*, 173 N.C. 269, 91 S.E. 946 (1917). The plaintiffs in this case were not damaged by Farm Bureau's failure to defend or settle. The two cases upon which the Court of Appeals relied to sustain the judgment against the defendant, *Indiana Lumbermen's Mutual Ins. Co. v. Champion*, 80 N.C. App. 370, 343 S.E.2d 15 (1986), and *Ames v. Continental Casualty Co.*, 79 N.C. App. 530, 340 S.E.2d 479, *disc. rev. denied*, 316 N.C. 730, 345 S.E.2d 385 (1986), involved actions by the insured. They have no application to this case.

327 N.C. at 425.

Thus, at least in dicta, the *Wilson* decision clearly leaves the prospect open for recovery in excess of coverage when a carrier has "wrongfully refused" to defend or settle.

It remains unclear whether there must be some "wrongful" or inappropriate conduct on the part of the insurer to trigger such excess exposure. In *Naddeo v. Allstate Ins. Co.*, 139 N.C. App. 311, 533 S.E.2d 501 (2000), the North Carolina Court of Appeals held that when an insurer "unjustifiably" refused to provide a defense, it was obligated to pay the entire tort judgment, and could not assert policy defenses alleging that the insured also breached other obligations. Since that policy had limits in excess of the underlying tort judgment, the case did not directly address whether the insurer would be obligated to pay in excess of its limits to satisfy a tort judgment for an "unjustifiable" refusal to provide a defense. More recently, in *Lozada v. The Phoenix Ins. Co.*, 237 F.Supp.2d 664 (M.D.N.C. 2003), the Court identifies this issue, but ultimately reaches its decision on other grounds, pointing out that it is the insured and not the third party plaintiff who is damaged when an insurer fails to provide a defense. *Cf. Nixon v. Liberty Mutual Ins. Co.*, 255 N.C. 106, 120 S.E.2d 430 (1962) (holding that settlement by insured in good faith, plus any reasonable expenses to effectuate the settlement would be recoverable within policy limits upon a showing of an inappropriate denial of coverage and a defense). *See generally*, Annot., *Right of Injured Person Recovering Excess Judgment against Insured to Maintain Action against Liability Insurer for Wrongful Failure to Settle Claim*, 63 A.L.R.3d 677 (1975).

It should be noted that several other jurisdictions have allowed recovery for damages resulting from various incidental expenses associated with a bad faith refusal to defend or settle in addition to an award against the carrier for the entire underlying tort action judgment. *See, e.g., Larraburu Bros. v. Royal Indemnity Company*, 604 F.2d 1208 (9th Cir. 1979) (applying California law and holding that recovery may be made from fact that insured went into bankruptcy as a result of personal injury judgment); *State Farm Mutual Auto Ins. Co.*, 381 F.2d 331 (5th Cir. 1967) *cert. denied*, 390 U.S. 1005 (1968) (applying Georgia law and holding insured may recover for punitive damages and for foreclosure on home). *See also*, Annot., *Recoverability of Punitive Damages in Action by Insured against Liability Insurer for Failure to Settle Claim against Insured*, 85 A.L.R.3d 1211 (1978).

Finally, in what can only be considered a mirror opposite of the failure to settle a tort liability claim made by a third party, in *Cash v. State Farm Mut. Auto Ins. Co.*, 137 N.C. App. 192, 528 S.E.2d 372, *affirmed per curiam*, 353 N.C. 257, 538 S.E.2d 569 (2000), the North Carolina courts have addressed a bad faith and unfair claims settlement practice claim asserted by an insured against his insurer for settling a claim that the insured maintained was meritless. While the Court noted that the auto insurer “owed the duty of good faith in carrying out its contract of insurance” it found that no bad faith or unfair claim handling practice claim was sustainable under the facts of that case. The Court indicated, “We hold that a cause of action alleging breach of good faith will not lie when the insurer settles a claim within the monetary limits of the insured’s policy; however, in doing so, we believe the insurer has the duty to consider the insured’s interests.” 137 N.C. App. at 204-205.

E. CLAIMS OF THIRD PARTIES AGAINST AN INSURER FOR BAD FAITH

1. Who Is a Third Party Who Has Standing to Sue?

In North Carolina, it appears that the relationship between the person seeking to recover for bad faith and the insurer is of some importance. That is, it appears that the North Carolina courts are interested in the relationship between the person complaining about the bad faith and the insurance contract that in some fashion creates the basis for the claim.

When a policy insures property or risks possessed by an insured and the triggering occurrence accident or other event obligates an insurer to pay directly to the insured some form of compensation for the loss, then the coverage is often referred to as first party coverage. Classic examples of this would be fire insurance for a house that burns down, collision coverage on an automobile, or coverage for theft or dishonesty of one’s employee. Generally, upon the occurrence of a covered event, the insurance company has a direct obligation to pay the insured (sometimes additionally a mortgage company or other person with an identifiable insurable interest as well) without the complications of the third corner of a triangle. Rather, there are basically two entities in this relationship, the insured and the insurer.

In contrast, in what is sometimes referred to as third party coverage, insurers will agree to protect an insured if a third party makes a claim against the insured for which the insured may be liable. This is a three way or triangular relationship. Classic examples of this type of coverage would be automobile liability coverage for one’s negligence causing bodily injury, general liability coverage for an injury at one’s place of work, such as a “fall down” claim or professional malpractice coverage for the protection of an insured who causes injury or damage to a third party.

It is generally recognized that named insureds and additional insureds, pursuant to a contract of insurance, should have the requisite standing and ability to bring a bad faith action for malfeasance by an insurance company, although sometimes issues arise as to whether

someone actually meets the definition of an insured with privity to sue pursuant to a particular policy, a different circumstance is found with liability coverage where the injured driver of the other car who was hit by the negligent insured, the person who fell at the office, or the person who suffered the malpractice may feel that they were not properly treated by the liability insurance company of the tort-feasor/insured. Current North Carolina case law appears to place some restrictions on the right of third parties to file a suit directly against an insurer.

Addressing first the issue of whether someone enjoys the status of an insured, thus giving them rights directly against an insurer for the insurer's malfeasance, it appears that persons who are obviously insured through the policy may directly bring suit. For example, insureds pursuant to fire loss coverage or other property coverage are able to directly bring suit against an insurer (see discussion *supra*). Further, it appears that persons insured for uninsured or underinsured coverage would enjoy the appropriate contractual relationship with the insured to bring bad faith actions, even though UM/UIM claims are in some respects not dissimilar to so-called "third party" claims since there is a tort-feasor. The distinguishing feature in that instance though appears to be that the insurer pays the insured rather than a third party (contrast liability coverage). (See discussion *supra*.)

While there is no doubt in a situation involving liability coverage that the insured who has purchased the protection has standing and the ability to prosecute claims for malfeasance by an insurance company, it is by no means clear that this right would extend to third parties who have claims against the insured. In *Wilson v. State Farm Mutual Insurance Company*, 327 N.C. 419, 394 S.E.2d 807 (1990), the North Carolina Supreme Court acknowledged but did not rule on the issue of whether a plaintiff injured by a defendant/insured has resort to a direct claim against the tort-feasor/insureds insurer for malfeasance in handling the claim. The Court noted "in this case we do not find it necessary to determine whether the plaintiffs, although they are not parties to the insurance contract, may proceed against . . . [the automobile liability insurer]." 327 N.C. at 419. See also, *Lozada v. The Phoenix Ins. Co.*, 237 F.Supp.2d 664 (M.D.N.C. 2003) (following *Wilson* and declining to allow a third party plaintiff to collect in excess of policy limits to enforce a breach of contract by insurer against its insured auto tort-feasor for failure to provide a defense to its insured).

Since *Wilson v. State Farm*, a number of Court of Appeals decisions have addressed whether a plaintiff in a separate action against an insured in tort has recourse directly against the tort-feasor's insurance company for insurer malfeasance in the handling of the claim. In *Wilson v. Wilson*, 121 N.C. App. 662, 468 S.E.2d 495 (1996) [it is confusing that two unrelated cases in this subtopic are captioned *Wilson*] the court addressed this issue in the context of an automobile liability policy. There, a plaintiff making claim against the automobile insurer for a negligent driver was held to not have the appropriate standing in relationship to the insurance contract to bring actions directly against the automobile insurer for bad faith (punitives) or for violations of Chapter 58 and 75 pertaining to unfair claims handling practices or unfair trade practices. The Court noted that "while this is an issue of first impression in our State, we have little difficulty in deciding the plaintiff's allegations are flawed." 121 N.C. App. at 665. The Court concluded that since the plaintiff was neither an insured nor in privity with the insurer as to this coverage, a private cause of action would not be available. *Id.*

The Court was concerned among other things about the leverage in the form of “unwarranted settlement demands” and other activities which would interfere with the resolution of the tort claim. *Id* at 666. It is interesting that in that particular case the plaintiff who was suing the automobile liability insurer of the tort-feasor, was actually his wife occupying his automobile at the time of the accident. The Court did not find that the fact that she was also an insured in the policy to be a factor in generating privity or standing as a insured for purposes of liability coverage. The Court noted that in this circumstance, the claimant’s relationship to Nationwide was that of “a third party because she seeks to recover from the insurer’s liability coverage provisions for her husband, rather than from a coverage provision providing for her own interests.” *Id* at 667.

In *Horton v. New South Insurance Company*, 122 N.C. App. 265, 468 S.E.2d 856, rev. denied, 343 N.C. 511, 472 S.E.2d 8 (1986), the Court avoided ruling on whether a claimant/plaintiff had a direct claim against a tort-feasor/insureds automobile insurer due to a failure of the complaint to allege an “independent basis” for the plaintiff to bring an action directly against the insurer. The Court held that since such independent claims were not raised at the trial court, they could not be raised for the first time on appeal. 122 N.C. App. at 269. C.F. *Prince v. Wright*, 141 N.C. App. 262, 544 S.E.2d 191 (2000) (holding no Chapter 75 claims arise against an insurer who inspected premises for the landlord/insured).

In contrast, in *Murray v. Nationwide Mutual Insurance Company*, 123 N.C. App. 1, 472 S.E.2d 358 (1996), rev. denied, 345 N.C. 344, 483 S.E.2d 172 (1997), the Court of Appeals held that the trial court improperly granted summary judgment against an injured plaintiff who had brought suit directly against the tort-feasor’s automobile insurer for bad faith in the handling of the auto claim. The Court in *Murray* distinguished its prior decision in *Wilson* in that in the *Murray* case the claimant had already obtained a judgment for the negligence of the insured defendant. The Court held that if a third party to an insurance contract is an intended beneficiary, the law applies privity of contract. The Court stated “the injured party in an automobile accident is an intended third party beneficiary to the insurance contract between insurer and the tort-feasor/insured party.” 123 N.C. App. at 15.

The Court distinguished the result in *Wilson v. Wilson*, *supra*, in that in *Murray*, the plaintiff had already obtained a judgment and would not be able to manipulate the underlying tort claim since it was concluded. The Court indicated “thus no *Wilson*-related pretrial safeguards were necessary here.” *Id* at 16. The Court noted that all of the activity complained of occurred after the underlying tort judgment had been obtained. *Id*. One cannot help but observe that the *Wilson* and *Murray* decisions are somewhat at odds with each other on their respective broader applications.

In *Terrell v. Lawyers Mutual Liability Insurance Company*, 131 N.C. App. 649, 507 S.E.2d 923 (1998), the Court held that a plaintiff/claimant who obtained a “memorandum of settlement” in which the insured/defendant agreed to confess judgment in the amount of \$75,000 and where the plaintiff/claimant agreed to execute such judgment only against a legal malpractice policy, lacked the requisite standing to directly assert a claim against the defendant’s insurance company. Although there was a “judgment” of sorts, it did not meet the

test of being an actual legal obligation to the tort-feasor/insured, since he was not personally obligated to pay it. On that basis, the court concluded that the insurer was not “legally obligated to pay” the claim under the terms of the policy and that therefore no duties or obligations were triggered between the insurance company and its insured. The court affirmed a dismissal of the plaintiff/claimant’s claims against the malpractice insurer, including apparently a claim for “tortious bad faith.”

In *Lee v. Mutual Community Savings Bank*, 136 N.C. App. 808, 525 S.E.2d 854 (2000), the Court affirmed a dismissal of claims for violation of N.C. Gen. Stat. § 75-1.1 allegedly involving the malfeasance of an insurer pertaining to mortgaged property. The Court held, pursuant to the *Wilson v. Wilson* reasoning, that the plaintiffs did not have the appropriate standing to bring a cause of action for unfair deceptive trade practices pertaining to an insurance company of an adverse party (here the mortgage company). 136 N.C. App. at 811.

More recently, in *Anderson v. Lancaster Aviator, Inc.*, 220 F.Supp.2d 524 (M.D.N.C. 2002), the Court again wrestled with the issues of privity and standing. In that case the Court held that the liability portion of a flight school’s liability policy would give rise to sufficient contractual privity necessary to give rise to a Chapter 75 claim, since the liability coverage was designed in part to protect the student pilot from third party claims based on his negligence. However, the Court declined to extend statutory unfair claims handling liability to alleged improper handling of the student pilot’s personal claims for medical expenses which the student pilot himself incurred in the plane crash, since these would apparently be in the nature of third party coverage to which he did not have privity of contract. It is interesting to note that in this opinion that the Court focused more on the fact in *Murray, supra*, that the liability insurance in that case was statutorily mandated (automobile insurance), than on the fact that the claimant occupied the status of a judgment-creditor, in establishing the claimant’s right to bring a claim against the insurer for the third party tort-feasor for a statutory unfair practices claim. 220 F.Supp.2d at 532-533.

In summary, it appears that the issue of who may bring a bad faith claim against an insurer of a tort-feasor will involve issues of standing and the right of a plaintiff/claimant to enforce claims for malfeasance against a tort-feasor’s insurer. With no definitive opinion from the North Carolina Supreme Court and some question of the application of the Court of Appeals decisions, this is an area of the law that will likely see continued refinement.

2. Can a Third Party Obtain the Right to Sue by Assignment or Subrogation?

As discussed in *supra*, a third party may or may not have direct standing and the right to sue an insurance company for malfeasance depending on that party’s relationship to the contract and the status of the underlying tort action. May a third party do indirectly what they might not otherwise be permitted to do directly, that is, receive some form of written assignment from the insured/tort-feasor to enforce that insured’s rights against the insurer. Several cases have looked at this issue and have reached somewhat unclear results. In *United States Fire Insurance Company v. Nationwide Mutual Insurance Company*, 735 F.Supp. 1320,

affirmed, 918 F.2d 955 (E.D.N.C. 1990), the Court declined to grant summary judgment on claims that were being asserted by an excess liability carrier against a primary liability carrier for bad faith and unfair claims handling practices which had been allegedly transferred to the excess carrier from the insured tort-feasor. The opinion references the entitlement to these sums by the excess carrier as an “assignee and subrogee” of the insured. The Court did not give a lengthy legal analysis for its ruling on this point. See also *Gray v. Grain Dealers Mutual Insurance Company*, 671 F.2d 1128 (D.C. Cir. 1989) (holding that an assignment and release by a tort-feasor/insured to plaintiff of bad faith claims is enforceable under North Carolina law).

However, in two North Carolina Court of Appeals opinions, the Court has taken a somewhat different approach. In *Horton v. New South Insurance Company*, 122 N.C. App. 265, 468 S.E.2d 856, *rev. denied*, 343 N.C. 511, 472 S.E.2d 8 (1986), the North Carolina Court of Appeals held that an attempted assignment of bad faith and unfair claims handling practices claims by a defendant/insured to a plaintiff/claimant on a liability policy would not be enforceable. The Court held that the bad faith claims based on the tortious breach of a contract would violate the public policy of the State of North Carolina. The Court stated “assignments of personal tort claims are void as against public policy because they promote champerty.” 122 N.C. App. at 268. Further, the Court held that likewise claims pursuant to the alleged breach of N.C. Gen. Stat. § 58-63-15 or 75-1.1 would likewise not be assignable since they also are based on “tortious acts” and are thus “unassignable personal torts.” *Id* at 269.

More recently, in *Terrell v. Lawyers Mutual Liability Insurance Company*, 131 N.C. App. 649, 507 S.E.2d 923 (1998), the North Carolina Court of Appeals again visited the issue of assignment of bad faith claims and held that an alleged tort-feasor/insured could not assign his rights from his legal malpractice policy to the plaintiff/claimant for alleged bad faith. There the Court noted specifically that the insurance policy had language providing that the interest of any insured in the policy “is not assignable.” 131 N.C. App. 60. The Court additionally found that bad faith claims would not be assignable as personal tort claims, citing as authority the prior *Horton v. New South* decision. *Id*.

Thus, certainly there is currently a cloud over the usage of an assignment to obtain a bad faith claim from an insured, at least from the Court of Appeals opinions that have to date addressed this issue.

3. Alternate Remedies for Third Parties Against Insurers.

Bad faith law may not be the only legal theory to obtain recovery from an insurance company with whom a claimant/plaintiff does not have direct contractual privity. For example, attorneys fees can be recovered pursuant to N.C. Gen. Stat. § 6-21.1 in certain actions where a Court finds coverage and a refusal to pay a settlement (albeit with a low maximum verdict cap in the tort action) under the right circumstances. See *e.g.*, *Jones v. Wainwright*, 149 N.C. App. 869, 561 S.E.2d 594 (2002) (outlining the requirements for showing of recovery of attorneys fees against third party insurer by claimant/plaintiff), *McDaniel v. McBrayer*, 164 N.C. App. 379, 595 S.E.2d 784 (2004) (application of test for eligibility for taxing of attorney fees against insurer.)

Similarly, it does not appear that independent torts committed by an insurer directly against a third party plaintiff/claimant, would be barred even without privity. See e.g., *Murray v. Nationwide*, 123 N.C. App. 1, 472 S.E.2d 358 (1996), *rev. denied*, 345 N.C. 344, 483 S.E.2d 172 (1997). If an insurer commits a tortious act directly against a third party claimant that does not require the existence of a duty pursuant to the insurance contract, it would seem that such a claim (perhaps, for example, for direct fraud against the claimant) would survive a lack of privity.

F. POTENTIAL DEFENSES TO CLAIMS FOR EXTRACONTRACTUAL LIABILITY

A number of defenses have been recognized to counter actions for extracontractual damages against insurance carriers. First, among these is certainly a defense that the activity complained of was not the result of bad faith, but rather was due to other reasons. For example, the North Carolina courts have recognized that imperfect but reasonable conduct alone will not support an action against an insurance carrier. See, e.g., *Wynnewood v. Travelers Ins. Co.*, 173 N.C. 269, 91 S.E. 946 (1917) (holding that a honest mistake by an insurer will not give rise to bad faith liability); *PT&F v. Robertson*, 157 F.Supp. 405 (1957) (acting erroneously but in good faith is a defense to a bad faith action); 75 N.C. App. 387, 331 S.E.2d 148, *review denied*, 314 N.C. 664, 336 S.E.2d 399 (1985) (so-called “Dailey II”) (a “honest disagreement” or an “innocent mistake” will provide a defense to a bad faith claim); *Olive v. Great American Ins. Co.*, 76 N.C. App. 180, 333 S.E.2d 41, *disc. rev. denied*, 314 N.C. 668, 336 S.E.2d 400 (1985) (a denial of coverage based on the construction of an insurance policy which “is neither strained no fanciful, regardless of whether it is correct” will not support an action for bad faith); *Shields v. Nationwide Fire Ins. Co.*, 50 N.C. App. 355, 273 S.E.2d 756, *cert. denied*, 303 N.C. 182, 280 S.E.2d 454 (1981) (holding that punitive damages will be disallowed for an insurer who has an arguable reason for denying an insurer’s claim, even if it is determined that such denial is unjustified).

Moreover, the mere misjudgment as to the value of a tort claim does not appear to automatically give rise to a cause of action for bad faith. See *Coca-Cola Bottling Company of Asheville v. Maryland Casualty Co.*, 325 F.Supp. 204 (W.D.N.C 1971).

However, it should be cautioned that mere payment of a claim may not automatically as a matter of law preclude a subsequent action for punitive damages, such that an insurer may step in at the eleventh hour and pay a claim to cut off any possibility of bad faith liability. See *Robinson v. N.C. Farm Bureau Mut. Ins. Co.*, 86 N.C. App. 144, 356 S.E.2d 392, *pet. for disc. rev. improvidently allowed*, 321 N.C. 592, 364 S.E.2d 140 (1987).

Since the muscle that implements bad faith claims is a right to recover punitive damages, naturally the statutory requirements for establishing punitive damages pursuant to Chapter 1D would necessarily need to be met. That is, there would need to be a showing of “fraud, malice, or willful or wanton conduct” as a standard of recovery for punitive damages. See N.C. Gen. Stat. §1D-15. Additionally, there would need to be a showing that such an aggravating factor is established by “clear and convincing evidence”. *Id.* Additionally there are caps on the right to recover punitive damages (See N.C. Gen. Stat. §1D-25) and procedural safeguards such as the right to demand a bifurcated trial (See N.C. Gen. Stat. §1D-30).

Additionally, as to punitive damages, there are constitutional issues that have been addressed as well. *See, e.g., State Farm Mut. Auto Ins. Co. v. Campbell*, 538 U.S. 408, 123 S.Ct. 1513, 71 U.S.L.W. 4282 (2003).

In other jurisdictions, there is a difference of opinion as to whether an offer of settlement within policy limits by the injured plaintiff is a prerequisite to liability for failure to settle a third party claim. *See generally*, P. Magarick, *Excess Liability: Duties and Responsibilities of the Insurer*, §10.04 (1982). Additionally, several decisions have held that if an insured agrees to the rejection of a compromise offer or a decision to try the case, the insured is barred from subsequent action for failure to settle. *See Jackson v. St. Paul Mercury Indemnity Co.*, 339 F.2d 40 (6th Cir. 1964); *Steven v. Northwestern National Casualty Co.*, 305 F.2d 513 (6th Cir. 1962); *Royal Transit v. Central Surety & Ins. Corp.*, 168 F.2d 345 (7th Cir. 1948). *See also, Puritan Ins. Co. v. Canadian Universal Ins. Co.*, 775 F.2d 76 (3rd Cir. 1985) (insured's consent and instruction to try an action barred a bad faith action by the excess carrier against the primary carrier who defended the action).

Suspected collusion between an insured and a plaintiff has been recognized as a possible defense from excess liability. *State Auto Ins. Co. v. York*, 104 F.2d 730, *cert. denied*, 308 U.S. 591 (4th Cir. 1939) (construing North Carolina law).

Another interesting defense is that of the following the recommendation of a position advocated by legal counsel. Some jurisdictions indicate this is a good defense, while others indicate it is only one indicia of good faith. *See Magarick, supra*, at §11.20. Conversely, failure to follow advice of counsel has on occasion been recognized as some evidence of bad faith. *Id.* *See also*, Annot., *Reliance on, or Rejection of, Advice of Counsel as Factor Affecting Liability in Action against Liability Insurer for Wrongful Refusal to Settle Claim*, 63 A.L.R.3d 725 (1975). *Cf., Evans v. USAA*, 142 N.C. App. 18, 541 S.E.2d 782, *pet. denied*, 353 N.C. 371, 547 S.E.2d 810 (2001) (addressing discoverability of attorney communications where insurer apparently did not want to assert advice of counsel as a defense).

Finally, the prior prejudicial breach of a duty or duties by an insured under the policy may void all coverage under the policy, and thus would raise the possibility of a bar to recovery in a bad faith action. *Cf., Great American Ins. Co. v. Tate Construction Co.*, 315 N.C. 714, 340 S.E.2d 743 (1986) (holding that no coverage available under a policy due to late notice of a claim to the insurer). Moreover, there is some suggestion that ratification, estoppel, waiver and contributory negligence are all viable defenses based on inappropriate acts of persons other than the primary insurer. *See, United States Fire Ins. Co.*, 735 F.Supp. 1320 (E.D.N.C. 1990), *aff'd*, 918 F.2d 955 (1990).

While in *Pearce v. American Defender Life Ins. Co.*, 316 N.C. 461, 343 S.E.2d 174 (1986), the Court suggests that "bad faith" is not necessary in order to establish recovery under Chapter 75, it would seem that some but not all of the list of prescribed insurance claims practices contained in subsection (11) implicitly adopts a standard of "reasonableness" and "good faith"

based on the wording of the described activities to be avoided. It is uncertain if the requirement of a pattern or practice of unfair practices in order to recover under those statutory provisions, which is mentioned in some precedent, is still a viable defense in light of *Gray v. N.C. Ins. Underwriting Assn*, 352 N.C. 61, 529 S.E.2d 676, *reh'g denied*, 352 N.C. 599, 544 S.E.2d 771 (2000). Compare, *Central Carolina Bank & Trust Co. v. Security Life of Denver Ins. Co.*, 247 F.Supp.2d 791, 803-04 (M.D.N.C. 2003) (seeming to indicate that Section 58-63-15(11) claims require a showing of immoral, unethical, or unscrupulous conduct).

Since the duties giving rise to bad faith claims derive from an insurance contract, it would seem that the statute of limitation for a bad faith action would be three years from the date of the breach of the implied covenant in the contract of good faith and fair dealing. See N.C. Gen. Stat. §1-52(1). Since claims for recovery under North Carolina's unfair claims handling statute in the past have been implemented through the provisions of Chapter 75, it would seem logical that claims under that theory of recovery would be governed by N.C. Gen. Stat. §75-16-.2 which provides for a four-year statute of limitation from the date the cause of action accrues.

G. APPENDIX

A Summary of Topics to Consider in Meeting With an Insured

Who Has Standing?

- Is client an insured or a third party beneficiary to a contract?
- Has the client suffered direct damages?

What is the Contract?

- Do you have the policy or key policy language?
- Is contract amended or modified by endorsements or by applicable law.
- What is the wording of the actual insuring agreement needed to trigger coverage?
- Do you have the right version or policy period before you?
- Is there more than one contract that might be applicable?
- Is it a contract governed by North Carolina Law?
- Is there an issue as to appraisal, arbitration or other procedure?

What Does the Insurer Say About the Claim?

- Any “reservation of rights” or denial letter that has been written by the insurer?
- Any communications with the consumer protection section of the Department of Insurance?

What Does the Insured or Beneficiary Say About the Claim?

- Any proof of loss form, claim form, or other paperwork to file the claim?
- Any letters or e-mails to the insurer?
- Recorded statement taken?
- Any communications with the Department of Insurance?
- Any breach by insured of duties under the policy?
- What does the insured say is the most troublesome part of the claim?

What is the Timeline On the Claim?

- What is the likely trigger date for the Statute of Limitations on this claim? Federal or State claim?
- Is any paperwork or filing due, such as a Proof of Loss Form, Claim Form, Appeal Form or denial in an internal review process with the company?
- Will any deadlines expire while you decide whether to take the case?

What are the Damages?

- Does this person have standing to claim these damages?
- What is the size range of the damages?
- Is there potential for extra-contractual or statutory treble damages based on the conduct. [A good start is to review N.C. Gen. Stat. §58-63-55(11)].
- What has already been paid to date?