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ARTICLE

An Overview of the Distinct Categories of Bad Faith and the Implications of Recovery in Different States

By John Vishneski III, Shanti Eagle, Jalen Brown, Andrew Athenson, J. Mark Hart, and Benjamin Reardon– February 20, 2025

Jurisdictions across the United States take on different approaches to bad faith actions. Bad faith litigation is a recourse for policyholders when an insurance company does not hold up its end of the bargain and does not fairly pay a claim. However, across the United States there are distinct categories of bad faith and different approaches that states will take to provide policyholders with a recourse in pursuing a bad faith claim against an insurer. This includes common law bad faith, which is developed through case law and the legal precedent of that specific state. The other basis for bad faith is through statutory law, which is based on state laws that were codified by lawmakers. Lastly, some jurisdictions address bad faith refusal to settle as a separate and distinct cause of action for bad faith. This article identifies the main categories of bad faith actions: tort-based bad faith, statutory bad faith, and bad faith refusal to settle, and identifies the implications for recoveries.

Tort-Based Bad Faith

Some jurisdictions consider the duty of good faith and fair dealing to be a tort duty that arises from the relationship between insurer and insured. In these jurisdictions, a breach of the duty of good faith and fair dealing supports tort damages, including consequential damages and, in many cases, punitive damages.

This includes Florida, which recognizes common law bad faith causes of action. In *Boston Old Colony Ins. Co. v. Gutierrez*, 386 So. 2d 783 (Fla. 1980), the Florida Supreme Court held that "[a]n insurer, in handling the defense of claims against its insured, has a duty to use the same degree of care and diligence as a person of ordinary care and prudence should exercise in the management of his own business." *Boston Old Colony Ins. Co.*, 386 So. 2d at 785.

In California, in first-party claims, bad faith is measured by the reasonableness of the insurer's conduct in investigating, evaluating, and paying or offering to compromise the insured's claim. *Wilson v. 21st Century Ins. Co*., 171 P.3d 1082, 1088 (2007), *as modified* (Dec. 19, 2007); *Brehm v. 21st Century Ins. Co.*, 83 Cal. Rptr. 3d 410, 422 (2008), *as modified* (Oct. 6, 2008). "An insurer owes to its insured an implied-in-law duty of good faith and fair dealing that it will do nothing to deprive the insured of the benefits of the policy." *Gruenberg v. Aetna Ins. Co*., 510 P.2d 1032, 1038 (1973) (quotations and citations omitted). The insurer must give at least as much consideration to the insured's interests as it does to its own in fulfilling its obligations. *Egan v. Mut. of Omaha Ins. Co*., 620 P.2d 141, 145 (1979). Breach of the implied covenant gives rise to tort damages, including policy benefits, consequential damages, emotional distress, attorneys' fees and costs, and can support a finding of punitive damages (upon a further finding of oppression, fraud, or malice). *Jordan v. Allstate Ins. Co*., 56 Cal. Rptr. 3d 312, 324 (2007), *as modified* (Apr. 20, 2007).

Washington's bad faith jurisprudence is based heavily on statutes discussed below. However, Washington also recognizes the tort of bad faith claims handling. *Safeco Ins. Co. v. Butler,* 823 P.2d 499 (1992). "In order to establish bad faith, an insured is required to show the breach was unreasonable, frivolous, or unfounded." *Kirk v. Mt. Airy Ins. Co*., 951 P.2d 1124, 1126 (1998). The insurer must not put its own interests over the insured's interests. *Coventry Assocs. v. Am. States Ins. Co*., 961 P.2d 933, 938 (1998). Washington also allows first-party bad faith claims to be maintained even in the absence of coverage for the loss. *Coventry Assocs. v. Am. States Ins. Co*., 961 P.2d 933, 937 (1998). Moreover, an insured may be entitled to "coverage by estoppel" where the insurer acts in bad faith. *Safeco Ins. Co. of Am. v. Butler*, 823 P.2d 499, 505 (1992).

Additionally, many other states take this tort-based approach to bad faith, including Mississippi and Alabama. Under Mississippi law, a legal claim for bad faith refusal to pay an insurance claim is an independent tort separate and distinct from any claim for breach of contract. *Weems v. Am. Sec. Ins. Co*., 486 So. 2d 1222, 1226 (Miss. 1986) (citing *State Farm Fire and Casualty Co. v. Simpson*, 477 So. 2d 242, 250 (Miss. 1985). In *Standard Life Ins. Co. of Indiana v. Veal*, 354 So. 2d 239, 249 (Miss. 1977), the Supreme Court of Mississippi first recognized that an insured can be awarded extra-contractual / punitive damages based on an insurer "arbitrarily refusing to pay legitimate [insurance] claims."

Further, the Alabama Supreme Court in *Nat'l Sec. Fire & Cas. Co. v. Bowen,* 417 So. 2d 179, 183 (Ala. 1982), noted the elements of a common law bad faith action. In short, a plaintiff must go beyond a mere showing of nonpayment and prove a *bad faith* nonpayment, a nonpayment without any reasonable ground for dispute. Or, stated differently, the plaintiff must show that the insurance company had no legal or factual defense to the insurance claim.

Statutory Bad Faith
Other jurisdictions have moved away from recognizing common law actions and instead have enacted a statutory scheme governing bad faith actions.

Illinois' legislature enacted a statutory basis for bad faith. Under 215 Ill. Comp. Stat. 5/154.6, an insurer must not engage in improper claims practice. Such practices include: ". . . (d) [n]ot attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear . . . ." It should be noted that this statute provides direct recourse for breach of contract under the policy for first-party claimants. In Illinois, a party that can prove vexatious and unreasonable conduct can recover $60,000 in punitive damages plus attorneys' fees in the coverage action. The statute has been held to pre-empt common law causes of action for bad faith, except for when an insurer acts in bad faith in responding to a settlement offer.

The Florida Legislature has also created a statutory first party bad faith cause of action in 1982 when it enacted section 624.155, Florida Statutes. While there have been amendments to the statute since its enactment, the Florida Legislature made sweeping changes to the statute through the tort reform legislation that went into effect on March 24, 2023. Under the current version of the statute, "any person may bring a civil action against an insurer" when the person is damaged by the insurer's violation of certain listed statutes or if the insurer:

1. Does not attempt "in good faith to settle claims when, under all the circumstances, it could and should have done so, had it acted fairly and honestly toward its insured and with due regard for her or his interests";

2. "Mak[es] claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which payments are being made"; or

3. "Except as to liability coverages, fail[s] to promptly settle claims, when the obligation to settle a claim 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."

§ 624.155(1), Fla. Stat.

The revisions to section 624.155 do not apply retroactively and therefore, will apply only to policies that are entered into and/or renewed and claims that arise after March 24, 2023. How Florida courts will apply this new statutory scheme is yet to be determined.

Washington has two separate statutory schemes that an insured can sue under to recover damages in the alternative, or in addition to common law bad faith. Under the Insurance Fair Conduct Act (IFCA), an insured who is unreasonably denied coverage may recover all damages sustained, reasonable attorneys' fees and costs, and treble damages. Wash. Rev. Code Ann. § 48.30.015. Violations of the specified insurance regulations, including unfair claim settlement practices, misrepresentation of policy provisions, and failures to promptly and fairly investigate claims, all give rise to the same remedies. Wash. Rev. Code Ann. § 48.30.015.

Second, Washington insureds can bring claims under the Consumer Protection Act (CPA). Wash. Rev. Code Ann. § 19.86.020. To successfully bring an action under the CPA, a plaintiff must prove an unfair or deceptive act or practice, among other elements. Bad faith claims practices, violations of the IFCA, and violations of the insurance regulations, can all be the basis for an action under the CPA. CPA claims are treated similarly to common law bad faith and may be maintained in the absence of coverage. *Coventry Assocs. v. Am. States Ins. Co*., 961 P.2d 933, 935-937 (1998).

California has similar regulations to Washington governing the standards insurers should uphold in claims handling. The Unfair Claims Practices Act requires insurers to attempt "in good faith to effectuate prompt, fair, and equitable settlements" after liability has become "reasonably clear." Cal. Ins. Code § 790.03. While in California violation of the regulations is not an independent basis for recovery, violation of the regulation can be used as evidence of unreasonableness, to prove common law bad faith. *Jordan v. Allstate Ins. Co.*, 56 Cal. Rptr. 3d 312, 323 (2007), *as modified* (Apr. 20, 2007). And California recently enacted a statute which, for certain pre-suit settlement offers, creates statutory requirements for what constitutes a "reasonable settlement offer" upon which bad-faith liability for failure to settle can potentially attach. Cal. Civ. Proc. Code §§ 999–999.5.

Bad Faith Refusal to Settle

Separate and distinct from common law "bad faith" actions, some jurisdictions recognize bad faith actions relating to an insurer's refusal to settle.

As mentioned above, currently, there is no common law "bad faith" tort action under Illinois law. However, an insured may assert a common law action against a liability insurer that has failed to act in good faith in responding to a settlement offer. *Cramer v. Ins. Exchange Agency*, 174 Ill. 2d 513 (1996). The duty to settle does not arise until there is a *reasonable probability* of (1) recovery in excess of policy limits and (2) a finding of liability against the insured. *Chandler v. American Fire and Cas. Co.*, 377 Ill. App. 3d 253, 257 (4th Dist. 2007). Moreover, the duty does not arise until a third-party demands settlement within the policy limits. *Haddick v. Valor Ins.*, 198 Ill. 2d 409 (2001). To determine if an insurer has breached the duty to settle, Illinois courts consider a variety of factors. *See O'Neill v. Gallant Ins. Co.*, 329 Ill. App. 3d 1166 (5th Dist. 2002).

Florida law requires an insurer "to refrain from acting in its own interests in handling the claim" and to "act with 'care and diligence.'" *Harvey v. GEICO General Ins. Co.*, 259 So. 3d 1, 8 (Fla. 2018). Accordingly, Florida courts evaluating bad faith consider the totality of the circumstances. *See Harvey*, 259 So. 3d at 7; *see also Brink*, 2023 WL 4549545, at *2. In other words, to determine whether an insurer "satisfied its duty," courts evaluate whether (1) the insurer advised the insured of settlement opportunities; (2) the insurer advised insureds on the probable outcome of litigation; (3) the insurer warned the insured of the possibility of an excess judgment; and (4) the insurer advised the insured of steps they might take to avoid an excess judgment. *Brink v. Direct General Ins. Co.*, 2023 WL 4549545, at *2 (M.D. Fla. July 14, 2023) (citing *Boston Old Colony*, 386 So. 2d at 785).

Further, in addition to the statutory provisions regarding bad faith settlement, Florida recognizes a common law claim for bad faith failure to settle that is not limited by section 624.155. *See Sarko v. Fireman's Ins. Co. of Newark, New Jersey*, 573 So. 2d 1076 (Fla. 4th DCA 1991) (Mem.); *see Vest*, 753 So. 2d at 1275. In *Berges v. Infinity Ins. Co.*, 896 So. 2d 665, the Florida Supreme Court explained that the issue in a bad faith failure to settle case "is whether, under all of the circumstances, the insurer could and should have settled the claim within the policy limits had it acted fairly and honestly toward its insured and with due regard for his interests." *Berges*, 896 So. 2d at 679. "The legal standard governing an insurer's settlement conduct is one of reasonableness." *Cruz v. Am. United Ins. Co.*, 580 So. 2d 311, 312 (Fla. 3d DCA 1991).

It is noteworthy that under Florida law, insurers have a duty "to affirmatively initiate settlement negotiations before a claimant makes a demand when 'liability is clear[ ] and injuries so serious that a judgment in excess of the policy limits is likely.'" *Nat'l Indem. Co. of the South v. Discout Rock & Sand, Inc.*, 2024 WL 1659947, at *2 (S.D. Fla. Mar. 5, 2024) (quoting *Powell v. Prudential Prop. & Cas. Ins. Co.*, 584 So. 2d 12, 14 (Fla. 3d DCA 1991)); *see also Harvey*, 259 So. 3d at 7.

In California, the implied covenant of good faith and fair dealing requires insurers to accept reasonable settlements within policy limits to avoid exposing the insured to excess liability. *Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 538 P.2d 744, 748 (1975). "The insurer, in deciding whether a claim should be compromised, must take into account the interest of the insured and give it at least as much consideration as it does to its own interest." *Comunale v. Traders & Gen. Ins. Co*., 328 P.2d 198, 201 (1958). An insurer who refuses a reasonable settlement offer within policy limits assumes the risk of damages in excess of applicable policy limits. *Johansen*, 538 P.2d at 746.

Washington also holds insurers liable for excess verdicts (or settlements) where the insurer unreasonably refuses to settle within policy limits. *Besel v. Viking Ins. Co. of Wisconsin*, 49 P.3d 887, 892 (2002). Through its bad faith, "the insurer 'has voluntarily forfeited its ability to protect itself against an unfavorable settlement.'" *Mut. of Enumclaw Ins. Co. v. Dan Paulson Const., Inc*., 169 P.3d 1, 13 (2007) (citations omitted).

Conclusion
Bad faith actions heavily depend on state specific law. Different jurisdictions take varying approaches, and each have their own requirements to prove an insurer's bad faith. When considering a bad faith cause of action, it is important for policyholders to be aware of how their jurisdiction applies bad faith. As shown above, some states allow for a policyholder to pursue a bad faith action through both the state's common law and/or through its statutory law, depending on the factual circumstances.

Disclaimer: This paper is jointly authored through a collaborative process through the American Bar Association's Insurance Bad Faith Sub-Committee, by attorneys representing policyholders and insurance carriers. The opinions expressed herein do not necessarily reflect the opinions of each of the authors, their firms, or their clients.