



ST. MARY'S
UNIVERSITY

Digital Commons at St. Mary's University

Faculty Articles

School of Law Faculty Scholarship

1992

Judicial Bias, the Insurance Industry and Consumer Protection: An Empirical Analysis of State Supreme Courts' Bad-Faith, Breach-of-Contract, Breach-of-Covenant-of-Good-Faith and Excess-Judgment Decisions, 1900–1991

Willy E. Rice

St. Mary's University School of Law, wrice@stmarytx.edu

Follow this and additional works at: <https://commons.stmarytx.edu/facarticles>



Part of the [Insurance Law Commons](#)

Recommended Citation

Willy E. Rice, *Judicial Bias, the Insurance Industry and Consumer Protection: An Empirical Analysis of State Supreme Courts' Bad-Faith, Breach-of-Contract, Breach-of-Covenant-of-Good-Faith and Excess-Judgment Decisions, 1900–1991*, 41 *Cath. U. L. Rev.* 325 (1992).

This Article is brought to you for free and open access by the School of Law Faculty Scholarship at Digital Commons at St. Mary's University. It has been accepted for inclusion in Faculty Articles by an authorized administrator of Digital Commons at St. Mary's University. For more information, please contact sfowler@stmarytx.edu, egoode@stmarytx.edu.

ARTICLES

JUDICIAL BIAS, THE INSURANCE INDUSTRY AND CONSUMER PROTECTION: AN EMPIRICAL ANALYSIS OF STATE SUPREME COURTS' BAD-FAITH, BREACH-OF-CONTRACT, BREACH-OF-COVENANT-OF-GOOD-FAITH AND EXCESS-JUDGMENT DECISIONS, 1900-1991

*Willy E. Rice**

TABLE OF CONTENTS

Introduction	326
PART I. An Overview of Theories of Recovery in Insurance Litigation: Breach of Express Contract; Breach of an Implied Covenant of Good Faith and Fair Dealing; Independent Tort of Bad Faith; and Theory of Excess Liability (Excess Judgment)	332
PART II. The Inconsistent Application of Legal Principles Involving First-Party Insurance	335
A. Conflict Over the Origin of the Insurer's Duty to Deal Fairly and in Good Faith	335
B. Conflict Over the Standard for Determining a Bad- Faith Breach of Duty	337

* Associate Professor of Law, Texas Tech University. M.A. 1972, Ph.D. 1975, University of North Carolina at Chapel Hill; Postdoctoral Fellow 1977, The Johns Hopkins University; J.D. 1982, The University of Texas at Austin. This research was supported in part with funds provided by the American Bar Endowment during the author's tenure as a visiting scholar at the American Bar Foundation. The author genuinely thanks Professors Spencer L. Kimball at the University of Chicago Law School, John J. Donohue at Northwestern University School of Law and Ian Ayres at Stanford Law School for evaluating the merits of the arguments and suggestions raised in the Article. Also, the author thanks his colleagues — Professors William Casto, Hadley Edgar, W. Frank Newton and Frank Skillern for reviewing some preliminary empirical findings. Any errors or omissions are the author's alone. In addition, the views expressed are the author's and not necessarily those of the American Bar Foundation.

PART III.	The Inconsistent Application of Legal Principles Involving Third-Party Insurance	340
	A. Interjurisdictional Conflicts Over Whether Insureds May Recover Damages in Excess of Policy Limits	341
	B. Interjurisdictional Conflicts Over Whether Assignees May Recover Damages in Excess of Policy Limits	344
	C. Interjurisdictional Conflicts Over Whether Third- Party Beneficiaries and Judgment Creditors May Recover Damages in Excess of Policy Limits	346
	D. Interjurisdictional Conflicts Over Whether Excess Insurers May Recover Damages in Excess of Policy Limits	350
PART IV.	A Case Study: The Disposition of Bad-Faith, Breach- of-Contract, Breach-of-Implied-Covenant-of-Good-Faith and Excess-Liability Actions in State Supreme Courts Between 1900 and 1991	357
	A. The Effects of Region of Country and Types of Federal Circuits on the Disposition of Suits in State Supreme Courts	362
	B. The Effects of Types of Insurance Contracts and Types of Complainants on the Disposition of Suits in State Supreme Courts	365
	C. A Multivariate Probit Two-Stage Analysis of the Disposition of Insurance-Related Cases in State Supreme Courts, 1900-1991	369
	D. Recommendations to Cure the Disparate Treatment of Aggrieveds Whose Insurance- Related Claims are Resolved in State Supreme Courts	377
PART V.	Conclusion	382

Most businesses and millions of individual consumers purchase insurance as protection against a variety of risks associated with life and property-threatening events, such as accidents, severe weather, earthquakes, diseases, and traffic mishaps.¹ Also, thousands of consumers purchase pension plans

1. See ALAN I. WIDISS, *INSURANCE: MATERIALS ON FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES AND REGULATORY ACTS* 1 (1989) [hereinafter WIDISS] (“[I]nsurance is purchased by most businesses to transfer at least some portion of the risks associated with the fabrication, distribution, and use of manufactured or processed products”).

and nursing-home coverage as safeguards against risks associated with old age.² Simply expressed, the two trillion dollar³ American insurance industry is enormous.

Unfortunately, consumers are becoming increasingly dissatisfied with the services and products that the insurance industry provides.⁴ Correspondingly, they are filing an ever-increasing number of lawsuits⁵ against insurers in state courts—"the workhorse of the nation's courts."⁶ While courts have ruled equally in favor of insurers⁷ and policyholders, advocates for both consumers and the insurance industry strongly believe "judicial bias" or "judicial hostility" permeates state supreme courts.

Some U.S. Supreme Court Justices have argued that state supreme courts are hostile towards insurance carriers.⁸ Commentators also have viciously

2. See Albert B. Crenshaw, *Insurance Industry Pitfalls Can Be Avoided With Care: Consumers Should Check Out Ratings of Companies*, WASH. POST, Apr. 21, 1991, at H3; see also Soi S. Fine, *Voice of the People — Medicap Ills*, CHI. TRIB., July 23, 1990, at 10 ("Nearly 23 million older Americans spend \$15 billion every year on premiums for private Medicare supplemental health insurance known as Medigap policies . . . to protect themselves against health care costs and to protect their savings.").

3. See Paulette Thomas, *Powerful Insurance Lobby is Being Fragmented Just When It Needs to Put a Premium on Unity*, WALL ST. J., June 27, 1991, at A16; see also William B. Crawford Jr., *CBOT Submits Insurance Products to CFTC*, CHI. TRIB., June 27, 1990, at 3 (stating that each year, the industry collects "approximately \$400 billion in premiums").

4. See, e.g., *Insurance Industry Target in Rising Spate of Lawsuits*, L.A. TIMES, May 30, 1989, at 9 ("Americans . . . are increasingly turning to the courts to settle disputes of all types. And lawyers say there is a growing realization that the insurance industry has vast financial resources that can be tapped. . . . Also, there is anger in many quarters toward the industry.").

5. *Id.*

Not only has the number of normal claims-related lawsuits increased, but the industry itself is embroiled in high-stakes legal battles that pit it against the government and private industry. . . . For example[,] [i]nsurance companies have been sued by more than 200 manufacturers . . . over who will pay the bill for cleaning up America's toxic waste sites. . . . A sweeping antitrust lawsuit [was] filed by 19 state attorney generals, accusing leading insurers of conspiring to restrict liability coverage for businesses and municipalities . . . [And] [t]he Department of Justice has sued three leading insurers, . . . claiming that Medicare erroneously paid millions of dollars in claims that the three companies should have covered.

Id.

6. Amy D. Marcus & Arthur S. Hayes, *Filings of State Tort Suits Jumped in '89*, WALL ST. J., May 7, 1991, at B8. The National Center for State Courts found that "[n]early 100 million new cases were added to the dockets of the nation's state court system in 1989." More important, the National Center's court statistics also revealed a sharp increase in the number of tort suits filed in state courts. *Id.*

7. See *supra* note 4, at 9.

8. Arguments appearing in *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813 (1986), illustrate the view that state supreme courts are anti-insurer. In *Lavoie*, Aetna Life claimed that Justice Embry and "all the other justices of the Alabama Supreme Court" were personally biased against the company. *Id.* at 825. In particular, Aetna accused Justice Embry of exhibiting general hostility towards, and general frustration with, all insurance companies. *Id.* at 818,

criticized state supreme courts for being biased against insurance carriers.⁹

820. The United States Supreme Court found no general bias or hostility toward Aetna Life. The Court did find, however, that Justice Embry's participation and pecuniary interest in a similar Alabama lawsuit violated Aetna's *substantive due process rights* under the Fourteenth Amendment. *Id.* at 822, 824 ("At the time Justice Embry cast the deciding vote and authored the court's opinion, he had pending at least one very similar bad-faith-refusal-to-pay lawsuit against Blue Cross in another Alabama court. . . . Thus, Justice Embry's opinion for the Alabama Supreme Court has the clear and immediate effect of enhancing both the legal status and the settlement value of his own case.").

Most state courts, however, are reluctant to find a substantive due process violation. *See Ware v. United States Fidelity & Guar. Co.*, 577 A.2d 902, 905 (Pa. Super. 1990) (holding that to prove that a trial judge's bias or impartiality violated a consumer's due process rights, "[a] party seeking recusal must assert specific grounds in support of the recusal motion . . . [and] may not raise the issue of judicial prejudice or bias for the first time in post trial proceedings"); *State Farm Mut. Auto. Ins. Co. v. Schlossberg*, 570 A.2d 328, 334 (Md. App. 1990) ("No timely request for recusal was made; therefore, an after-the-fact request for recusal was properly denied."); *Ainsworth v. Combined Ins. Co.*, 774 P.2d 1003, 1015 (Nev. 1989) (holding that certain "procedural irregularities" were insufficient evidence to establish that former Chief Justice Gunderson was biased and that his alleged impartiality violated the insurer's due process rights); *Violette v. Midwest Printing Co.-Webb Publishing*, 415 N.W.2d 318, 326 (Minn. 1987) (finding "no denial of due process based on the judges' refusal to disqualify themselves"); *Rosemond v. Prudential Property & Casualty Ins. Co.*, 316 S.E.2d 541, 543 (Ga. App. 1984) (holding that the trial judge's alleged expressions of bias did not violate the consumer's due process rights).

But Justice O'Connor supports the view that state supreme courts are hostile toward insurance carriers. In *Pacific Mut. Life Ins. Co. v. Haslip*, 111 S. Ct. 1032 (1991), Justice O'Connor wrote a stinging dissenting opinion in which she criticized the Alabama Supreme Court for "giv[ing] civil juries complete, unfettered, and unchanneled discretion to determine whether . . . to impose punitive damages" against unpopular defendants like insurance companies. *Id.* at 1058. According to Justice O'Connor, Alabama's common-law, punitive-damages scheme violates both procedural and substantive due process. *Id.* at 1056-57. "Unfortunately, Alabama's punitive damages scheme is indistinguishable from the common-law schemes employed by many States." *Id.* at 1056. The scheme "redistribute[s] wealth," *id.*, and allows "individual jurors to rely upon emotion, bias, and personal predilections of every sort." *Id.* at 1057; *see also, McCorkle v. Great Atlantic Ins. Co.*, 637 P.2d 583, 588 (Okla. 1981) (arguing that the "impositi[on] of tort liability on [insurance companies] alone for a breach of . . . duty which is present in all contracts' is 'a denial of . . . equal protection under both the United States and Oklahoma Constitutions.'" (omission in original)). The Oklahoma Supreme Court, however, refused to "address the equal-protection argument [because] it was not timely raised"). In short, Justice O'Connor argued that Alabama's and other states' schemes for awarding punitive damages are biased against insurance companies because offending carriers may receive adverse judgments "as high as \$10 million, \$25 million, and \$50 million." *Haslip*, 111 S. Ct. at 1058. *But see McCorkle*, 637 P.2d at 588 (accepting the view that an award of punitive damages for the bad-faith handling of a consumer's fire-loss claim does not deny procedural due process for the insurance industry or unfairly protect consumer to the prejudice of the insurance industry). The court in *McCorkle* justified its decision by noting: "[O]ne of the primary reasons a consumer purchases any type of insurance (and the insurance industry knows this) is the peace of mind and security that it provides in the event of loss." *Id.*

9. For example, one commentator accused "anti-insurer courts" of using a "pro-insurer rule to achieve an anti-insurer result" in settlement cases. *See Davis J. Howard, Apportioning an Insurer's Liability Between Covered and Noncovered Parties and Claims*, 38 FED'N INS. &

The contrary view that state supreme courts are anti-consumer is also widespread.¹⁰

CORP. COUNS. Q. 319, 340 (1988). Moreover, some jurists have criticized supreme courts for indulging consumers. *Grandpre v. Northwestern Nat'l Life Ins. Co.*, 261 N.W.2d 804, 808 (S.D. 1977) ("The insurance industry is a risk industry, operated on a supposedly sound actuarial basis. . . . We cannot expect the insurers to write their contracts in the language of children's primers, 'see the dog run, run dog run' style."). Other courts take a more consumer-oriented approach:

the reasonable-expectations doctrine does not automatically mandate either pro-insurer or pro-insured results. It does place a burden on insurance companies to communicate coverage and exclusions of policies accurately and clearly. It does require that expectations of coverage by the insured be reasonable under the circumstances. Neither of those requirements seems overly burdensome.

Atwater Creamery Co. v. Western Nat'l Mut. Ins. Co., 366 N.W.2d 271, 278 (Minn. 1985). Still other commentators cite the length of various state-court opinions as evidence of judicial bias and hostility toward insurance carriers. For example, some commentators accuse supreme court judges of deliberately writing shorter and simpler anti-insurer decisions to reduce the precedential value of such rulings. See Kenneth F. Oettle and Davis J. Howard, *D&O Insurance: Judicially Transforming a "Duty to Pay" Policy into a "Duty to Defend" Policy*, 22 TORT. & INS. L.J. 337 (1987). Oettle and Howard argue that pro-insurer decisions are:

short and simple and therefore less likely to be reported. By contrast, pro[-]insured decisions . . . tend to be long and complicated since the courts deciding them often attempt to create an analytical framework capable of justifying coverage when the language of the policy would seem to require otherwise. . . . [B]ecause [pro-insured decisions] are long and complicated, these decisions [are more] likely to be reported and . . . obtain precedential value.

Id. at 346 n.25. See also Peter C. Haley and Brandt L. Wolkin, *Bad Faith and the Financial Institution Bond*, 25 TORT & INS. L.J. 715, 719 (1990) [hereinafter Haley & Wolkin] ("because the current judicial bias is unfavorable . . . , bonding companies must develop clear claims investigations procedures. . . . These efforts will help negate claims by the insured about unequal bargaining power and lack of sophistication").

10. For example, in *State Farm Mut. Ins. Co. v. Blevins*, 551 N.E.2d 955 (Ohio 1990), Justice Sweeney wrote a strong dissenting opinion in which he criticized the majority for construing ambiguous policy language "in favor of the insurer and against the insured." *Id.* at 960. According to Justice Sweeney, the majority of the Ohio Supreme Court is "decidedly anti-consumer" and would rather protect the drafters of insurance contracts than protect consumers. *Id.* at 959. He noted that:

[T]he majority resorts to judicial legislation in order to protect not consumers, but drafters of insurance contracts The liberal construction rule of law has become hollow indeed, since here the majority has acknowledged that it will rescue inartfully drafted insurance contract language by imposing a presumption of non-recoverability in favor of the insurer who falls prey to such nebulous drafting.

Id. at 962.

In addition, an analysis of California politics supports the proposition that state supreme courts are anti-consumer.

In November 1988, [California] voters approved Proposition 103, which mandated a [minimum] 20% rollback in their premiums But the [California] Supreme Court eviscerated the law by ruling that insurers are entitled to a fair rate of return on equity in their auto lines, later determined . . . to be 11.2%. The rollbacks wouldn't have allowed most insurers such a return.

Are state supreme courts truly biased against the insurance industry? Or are certain regional state supreme courts more likely to issue anti-consumer opinions? Some consumer advocates, commentators, insurance carriers and justices believe state supreme courts are inherently biased against or in favor of insurers and policyholders. As of this writing, a systematic, empirical investigation of "judicial bias"—involving state supreme courts, consumers and the insurance industry—has not been undertaken.

While no universal, legal definition of "judicial bias" exists, it may be defined in at least two different ways. First, "judicial bias" may be intentional, which "is a leaning of the mind or an inclination toward one [litigant] over another."¹¹ Such bias is intentional discrimination, where a judge's personal interests shape the outcome of a case. This discriminatory conduct is grounds for disqualifying a state trial, appellate or supreme court judge.¹²

The second type of "judicial bias" resembles disparate-impact discrimination.¹³ This is unintentional bias;¹⁴ it occurs when immaterial factors such

Chip Johnson, *A Legislative Free-for-All Rages as Californians Strive to Bring Down the Cost of Auto Insurance*, WALL ST. J., May 14, 1991, at A24. The insurance commissioner and other groups are angry, because they believe "a fair return is a lot less than 11.2%." *Id.*

11. *Cline v. Sawyer*, 600 P.2d 725, 729 (Wyo. 1979). *See also*, *Pote v. State*, 733 P.2d 1018 (Wyo. 1987). In *Pote*, the Wyoming Supreme Court elaborated the definition of intentional bias it originally adopted in *Cline*, noting that "conditions must exist which reflect pre-judgment of the case by the judge or a leaning of his mind in favor of one party to the extent that his decision in the matter is based on grounds other than the evidence placed before him." *Id.* at 1021.

12. *Id.* ("The 'bias' which is a ground for disqualification of a judge must be personal"). *See also*, *supra* note 8.

13. The United States Supreme Court established the "disparate impact" theory of discrimination in a series of cases dealing with claims of employment discrimination. *See International Bhd. of Teamsters v. United States*, 431 U.S. 324 (1977); *Albermarle Paper Co. v. Moody*, 422 U.S. 405 (1975); *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971). Under the Court's "disparate impact" analysis, a Title VII plaintiff may state a prima facie employment discrimination claim by making a statistical showing that the neutral scheme caused the hiring disparity. *See* LEE M. MODJESKA, § 1.8 *Employment Discrimination Law* 30 (2d ed. 1988). But in the context of the present discussion, a "disparate impact" analysis permits a presumption, based on statistical showing, that a state supreme court's neutral rule, practice policy harms members of a certain group, such as female policyholders, automobile insurers, life-insurance insurers, or excess liability insurers.

14. *See* Jesse A. Witten, *Disparate Impact Doctrine Revisited: Wards Cove Packing Co. v. Antonio*, 109 S. Ct. 2115 (1989), 13 HARV. J.L. & PUB. POL'Y 383, 384-86 (1990). The author notes:

Disparate impact and disparate treatment are the two main theories on which individuals or classes may base employment discrimination claims under Title VII. Under the disparate treatment theory, the employee alleges that his employer has intentionally discriminated against him because of his membership in a protected class. By contrast, under the disparate impact theory, the employee alleges that a *facially neutral* practice . . . has had a disproportionately adverse effect on members of a protected class and is discriminatory.

as region of country, type of insurance contract, an insurer's state of incorporation or race of the insured unwittingly determine the outcome of judicial decisions. Stated differently, disparate-impact discrimination occurs when extralegal factors—those having little to do with the merits of a case—regularly and systematically influence state supreme court's decisions in favor of either the insurer or the policyholder. Such rulings are inherently biased because facially neutral, extralegal variables, rather than material evidence and legal principles, determine the disposition of lawsuits.

This Article focuses on the second type of "judicial bias"—disparate-impact discrimination. The Article examines whether state supreme courts are permitting extralegal factors to influence the disposition of suits involving breach of an implied covenant of good faith and fair dealing, breach of contract, tort of bad faith, and excess liability (excess judgment). An empirical analysis of state supreme court cases decided between 1900-91 was conducted to determine whether "judicial bias" exists.

Part I of the Article briefly describes four theories of recovery. In particular, the Article examines the rules of contract (express) law; the theory of implied covenant of good faith and fair dealing; the theory of an independent tort of bad faith; and the theory of excess liability (excess judgment). Part II surveys various theories of recovery among first-party suits. Part II then discusses the conflicting state supreme court rulings that imply that state tribunals favor one litigant over another. Part III analyzes third-party suits and discusses various inconsistent bad-faith and excess-liability decisions. Finally, Part IV discusses a disparate-impact analysis. The Article concludes that state supreme courts are unwittingly discriminating against litigants. Specifically, these supreme tribunals allow extralegal factors, which have little to do with the merits of the suits, to influence the disposition of insurance-related cases. More to the point, the Article encourages policyholders and insurance companies to settle their disputes in a state administrative forum. Trial by judge or by jury should be avoided and judicial review of any kind should be prevented.

Id. at 385 (footnotes omitted). See also Minna J. Kotkin, *Public Remedies for Private Wrongs: Rethinking the Title VII Back Pay Remedy*, 41 HASTINGS L.J. 1301, 1328-38 (1990) (outlining the significant differences between "disparate treatment" and "disparate impact" and noting that "questions of motivation" are excluded from the disparate-impact analysis).

I. AN OVERVIEW OF THEORIES OF RECOVERY IN INSURANCE
LITIGATION: BREACH OF EXPRESS CONTRACT; BREACH OF AN IMPLIED
COVENANT OF GOOD FAITH AND FAIR DEALING; INDEPENDENT TORT
OF BAD FAITH; AND THEORY OF EXCESS LIABILITY
(EXCESS JUDGMENT)

As early as 1872, the United States Supreme Court accepted the view that an insurance contract is an agreement to pay money.¹⁵ State courts, however, disagree on the type and amount of award an insured must receive when an insurer breaches that agreement. Much of this conflict stems from state supreme courts' adoption of competing theories of recovery.

History reveals that many state supreme courts adopted the principles outlined in the well-known 1854 English contract case, *Hadley v. Baxendale*,¹⁶ to settle disputes between insureds and insurers. State courts viewed insurance policies as another form of contract and, therefore, construed such policies according to strict principles of contract interpretation.¹⁷ Consequently, when deciding whether to compensate an aggrieved policyholder, courts examined the express terms of the contract. If a breach had occurred, the insured was entitled to receive only limited damages, plus interest.¹⁸ Further, the insured could not recover damages for mental distress, medical expenses or inconvenience; courts considered such compensation to be outside the contemplation of the parties when they consummated the insurance contract.¹⁹

Gradually, some state supreme courts recognized that an unwavering adherence to strict principles of contract law would be unjust. Thus, they applied another principle of contract law that an implied covenant of good faith and fair dealing exists in every insurance contract. In 1882, the Court of Appeals of Kentucky embraced this principle in *Germania Insurance Co.*

15. *Cf. Insurance Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 382 (1873).

16. 9 Ex. 341, 156 Eng. Rep. 145 (1854) (ruling that consequential damages are limited to those that naturally arise from the breach or that were reasonably foreseeable to the parties when the contract was made.)

17. E. Neil Young et al., *Insurance Contract Interpretation: Issues and Trends*, 625 INS. L.J. 71, 72 (1975) [hereinafter Young].

18. *See* *Bye v. American Income Life Ins. Co.*, 316 So. 2d 164, 166 (La. App. 1975) (holding that recovery for a breach is limited to the amount due within the policy limits, plus legal interest).

19. *See e.g., Kerwin v. Massachusetts Mut. Life Ins. Co.*, 295 N.W.2d 50, 53-54 (Mich. 1980) (ruling that a disability insurance policy is a commercial contract; therefore, damages only are recoverable for breaches which were within the contemplation of the parties when the contract was made); *Clark v. Life & Casualty Ins. Co.*, 53 S.W.2d 968, 969-970 (Ky. 1932) (holding that an aggrieved policyholder may not recover damages for mental distress).

*v. Rudwig & Co.*²⁰ Thirty-two years later, in *Brassil v. Maryland Casualty Co.*²¹ the New York Court of Appeals stressed that an insured's rights "go deeper than the mere surface of the contract,"²² because a contractual obligation of good faith underlies all written agreements including insurance policies. Moreover, the *Brassil* court held that insurers have an obligation of good faith to carry out both the express and implied terms of an insurance contract.²³

Perhaps, more than any other factor, the inconsistent application of the implied good faith principle explains why so many insurance-law litigants believe that "judicial bias" permeates state supreme courts. Under the principle of good faith and fair dealing, both disgruntled policyholders and third parties²⁴ may recover financial rewards for a number of violations,²⁵ including a breach of the express terms of the insurance policy. Nonetheless, both the amount and the types of damages recoverable under an implied covenant of good faith seriously divide state supreme courts. Some supreme tribunals allow both first-party and third-party plaintiffs to recover extensive consequential and punitive damages. Others restrict the amount of recoverable

20. 80 Ky. 223, 235 (1882) (stressing that an insured's innocent misrepresentations in a life insurance application do not grant the insurer the right to avoid the policy; such a result would subvert the "rule of good faith and fair dealing that should enter into and form a part of every insurance contract").

21. 104 N.E. 622 (N.Y. 1914).

22. *Id.* at 624.

23. *See id.*; *see also* *Bowler v. Fidelity & Casualty Co.*, 250 A.2d 580, 587-88 (N.J. 1969) ("Insurance policies are contracts of the utmost good faith and must be administered and performed as such by the insurer. Good faith 'demands that the insurer deal with laymen as laymen and not as experts in the subtleties of law and underwriting.'") (citations omitted). Other courts apply a more even-handed standard. *See United Serv. Auto. Ass'n v. Morris*, 741 P.2d 246 (Ariz. 1987). In *Morris*, the court stated:

Why shouldn't the insured be equally bound to respect the terms of the contract? . . . [T]here is in every insurance contract a covenant of good faith and fair dealing, implied in law, whereby each of the parties is bound to refrain from any action which would impair the benefits . . . [flowing] from the contract or [from] the contractual relationship.

Id. at 255-56.

24. *See generally, infra* notes 35-45 and accompanying text.

25. Other violations include: attempting to settle a claim without giving notice to the insured; compelling an insured to sue; delaying the investigation of a claim; delaying the payment of a claim; denying coverage outright; failing to acknowledge claims; failing to inform insured about the status of benefits; failing to investigate a claim; failing to defend a suit; failing to process a claim in a timely fashion; failing to settle claim in a timely manner; failing to settle within policy limits; intentionally inflicting emotional distress; refusing to issue a policy; refusing to pay a first-party claim; refusing to pay a third-party claim; and, terminating an employment contract. *See Royal Globe Ins. Co. v. Superior Court*, 592 P.2d 329, 331 n.1. (Cal. 1979) (listing unfair practices in the California Insurance Code), *overruled on other grounds, Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 758 P.2d 58 (Cal. 1988).

damages to the value specified in the policy-limits clause of the insurance contract.²⁶

In addition, another conflict arises—one more serious than the amount-of-recovery controversy:

Jurisdictions differ in their treatment of a breach of the implied covenant of good faith and fair dealing in [an] insurance context. Some jurisdictions characterize the cause of action as merely a breach of contract; others characterize the cause of action as a tort in third-party cases but not [in] first-party cases[.] [S]till others characterize the cause of action as a tort in both first-party and third-party cases.²⁷

Moreover, another rule further complicates this morass: under either a contract or an independent-tort-of-bad-faith action the insured may obtain consequential damages for economic loss and emotional distress and, when appropriate, punitive damages.²⁸

Finally, a careful analysis of first-party and third-party decisions reveals even deeper divisions among state supreme courts that recognize the tort of bad faith as an independent cause of action. For example, in suits involving first-party insurance, courts have reached conflicting results over whether damages should be awarded where insurers allegedly failed to process, investigate, defend, bargain, settle or pay a claim.²⁹ Moreover, in third-party insurance actions, a major controversy exists over the proper test for assessing whether an insurer is liable for a judgment in excess of the policy limits. Some supreme courts apply the doctrine of good faith and fair dealing when the complainant is a policyholder or an excess insurer. Other courts apply

26. Compare *Santilli v. State Farm Life Ins. Co.*, 562 P.2d 965, 969 (Or. 1977) (suggesting that under a strict contract approach, a breach of the covenant of good faith restricts the amount of recovery to the face value of the policy) with *Beck v. Farmers Ins. Exch.*, 701 P.2d 795, 801 (Utah 1985) (stressing that “there is no reason to limit damages recoverable for breach of a duty to investigate, bargain, and settle claims in good faith to the amount specified in the insurance policy”).

27. *State Farm Fire & Casualty Co. v. Nicholson*, 777 P.2d 1152, 1154-55 (Alaska 1989); see also, *Noble v. National Am. Life Ins. Co.*, 624 P.2d 866, 867 (Ariz. 1981) (observing that under the covenant of good faith and fair dealing, “[t]he duty to . . . act is imminent in the contract whether the company is attending to the claims of third persons against the insured or the claims of the insured itself”). For an excellent discussion of the evolution of the independent tort of bad faith, a representative list of relevant state supreme court cases and an outline of the arguments for and against this action, see *Spencer v. Aetna Life & Casualty Ins. Co.*, 611 P.2d 149, 151-53 (Kan. 1980).

28. See *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313, 319 (R.I. 1980) (recognizing that an insurer’s duty “to deal fairly and in good faith with an insured is implied by law”).

29. See generally, *infra* notes 46-49 and accompanying text.

the doctrine of subrogation³⁰ when the aggrieved party is an excess insurer.³¹ Arguably, the inconsistent application of bad-faith rules among first-party and third-party litigants contributes to the impression that state supreme courts unwittingly discriminate against consumers or in favor of the insurance industry.

II. THE INCONSISTENT APPLICATION OF LEGAL PRINCIPLES INVOLVING FIRST-PARTY INSURANCE

A. *Conflict Over the Origin of the Insurer's Duty to Deal Fairly and in Good Faith*

The previous section showed that while some state supreme courts allow insureds to sue insurance companies in tort for bad faith, others do not. But among those tribunals which recognize an independent tort action for bad faith, significant confusion exists over whether an insurer's duty to act responsibly is implied in fact³² or implied in law.³³ Stated differently, state supreme courts are seriously divided over whether the duty to satisfy the reasonable expectations of the insured evolves from the insurance contract, from the contractual relationship between the parties, or from some other body of law.

Much of this confusion stems from state supreme courts' use of imprecise language when deciding bad-faith causes of actions. Cases holding that an insurer's duty to act stems from the terms of the insurance contract support this observation. For example, Kentucky's highest court concluded that the "rule of good faith and fair dealing . . . form[s] a part of every insurance contract."³⁴ Conversely, the Arizona Supreme Court held that "the duty to . . . act is *imminent in the contract*."³⁵ To further complicate matters, the Supreme Court of Colorado decided that "[t]he basis for liability in tort . . .

30. For a definition of subrogation, see *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 137 (1962) (stating that under the doctrine of subrogation "a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed").

31. See generally, *infra* notes 119-30 and accompanying text.

32. Cf. *Watson Truck & Supply Co. v. Males*, 801 P.2d 639 (N.M. 1990). The court stressed that: "Whether express or not, every contract imposes upon the parties a duty of good faith and fair dealings in its performance and enforcement." *Id.* at 642. However, the court noted that the "[a]pplication of the covenant of good faith and fair dealing becomes difficult . . . where . . . it may be argued that from the covenant there is to be implied in fact a term or condition necessary to effect the purpose of a contract." *Id.*

33. See *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 203 (Cal. 1958) (noting that an implied covenant of good faith and fair dealing exists in every insurance contract, but the covenant is implied in law rather than implied in fact).

34. *Germania Ins. Co. v. Rudwig & Co.*, 80 Ky. 223, 235 (1882) (emphasis added).

35. *Noble v. National Am. Life Ins. Co.*, 624 P.2d 866, 867 (Ariz. 1981) (emphasis added).

is grounded upon the *special nature of the insurance contract*.³⁶ Nonetheless, that court, along with several other supreme tribunals, maintained that the duty to act arises from a contractual relationship³⁷ rather than from the contract.

Furthermore, an Oklahoma Supreme Court's decision illustrates another unnecessarily complicated bad-faith holding. Accepting the general notion that an insurer has a duty to deal fairly and in good faith with its insured, the Supreme Court of Oklahoma, unlike other supreme courts, maintained: "There must be *either a contractual or [a] statutory relationship* between the insurer and the party asserting the bad faith claim before the duty arises."³⁸

While the Supreme Court of Kansas has refused to recognize an independent tort of bad faith,³⁹ it has held that "only contractual damages are available for a breach of an insurance contract."⁴⁰ That ruling, however, is bothersome, because it only exacerbates the confusion surrounding bad-faith litigation. Thus, in Kansas, an insurance company's duty to deal fairly and in good faith evolves from a state-imposed statutory relationship⁴¹ rather than from a contractual relationship.

Finally, some courts have ruled that an insurer is a trustee; therefore, a quasi-fiduciary relationship exists between an insurance company and a policyholder.⁴² Specifically, Colorado, Florida, New Jersey and Wisconsin

36. *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1140-1141 (Colo. 1984) (emphasis added).

37. *Id.* at 1141. See also *Thomas v. Principal Fin. Group*, 566 So. 2d 735, 736 (Ala. 1990) (reiterating that bad faith is a failure of the insurer to perform his duty that stems from the contractual relationship); *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855, 858 (Wyo. 1990) ("The insurance contract is one of these special classes of contracts so that this duty of good faith and fair dealing imposed by law arises from the contractual relationship"); *United Fire Ins. Co. v. McClelland*, 780 P.2d 193, 197 (Nev. 1989) ("Liability for bad faith is strictly tied to the implied-in-law covenant of good faith and fair dealing arising out of an underlying contractual relationship"); *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790, 793-794 (Iowa 1988) ("it is appropriate to recognize the first-party bad faith tort to provide the insured an adequate remedy for an insurer's wrongful conduct. We think this recognition is . . . justified by the nature of the contractual relationship between the insurer and the insured").

38. *Roach v. Atlas Life Ins. Co.*, 769 P.2d 158, 161 (Okla. 1989).

39. *Spencer v. Aetna Life & Casualty Ins. Co.*, 611 P.2d 149, 158 (Kan. 1980).

40. *Id.* at 153.

41. *Id.* at 158. ("The legislature has provided several remedies for an aggrieved insured and has dealt with the question of good faith first party claims.")

42. WILLIAM M. SHERNOFF ET AL., *INSURANCE BAD FAITH LITIGATION* § 1.05 (1989) [hereinafter SHERNOFF]. Shernoff states that:

[U]nder conventional theory, there was no fiduciary relationship between an insurer and its insured. . . . However, this traditional contract approach seems to have been supplanted in large measure by the . . . judicial concept of an implied covenant of good faith and fair dealing, violation of which may give rise to a tort cause of action. . . . The modern approach seems to recognize that the relationship between the insurer and insured has a fiduciary character.

Supreme Courts have ruled that "an insurance company stands in a position similar to that of a fiduciary[.]" particularly when handling third-party claims brought against the insured.⁴³ In *Farmers Group, Inc. v. Trimble*,⁴⁴ the Supreme Court of Colorado held that insurance contract forms the basis of the quasi-fiduciary relationship.⁴⁵

B. Conflict Over the Standard for Determining a Bad-Faith Breach of Duty

In addition to the implied-in-law and implied-in-fact controversy, the standard for establishing an independent tort of bad faith is unclear. Is it an intent standard or a negligence standard? This issue confuses state supreme courts. Consequently, the results of these courts differ. Some courts that subscribe to the intent standard adopt an "objective" test. To maintain a bad faith claim under that test, the insured must demonstrate that the insurer did not have a reasonable basis for denying coverage. The insured must also show "defendant's knowledge or reckless disregard . . . for denying the claim."⁴⁶ This "objective standard" has been frequently labeled the "fairly-debatable" intent test and several states within the First, Seventh, Ninth and Tenth Circuits⁴⁷ have adopted it.

Id.

43. *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1141 (Colo. 1984). See also *Baxter v. Royal Indem. Co.*, 317 So. 2d 725, 726 (Fla. 1973) (recognizing as valid the rule that a fiduciary obligation exists between an insured and an insurer under an automobile insurance policy; *Rova Farms Resort, Inc. v. Investors Ins. Co.*, 323 A.2d 495, 507 (N.J. 1974) (holding than an insurer, "having contractually restricted the independent negotiating power of its insured, has a positive fiduciary duty to take the initiative and attempt to negotiate a settlement within the policy coverage"); *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368, — (Wis. 1978) (defining bad faith as an intentional tort arising from "a breach of [a fiduciary] duty imposed as a consequence of the relationship established by contract").

Other supreme courts refuse to adopt these positions. The Supreme Court of Utah, for example, has held "that in a first—party relationship between an insurer and its insured, the duties and obligations of the parties are contractual rather than fiduciary. Without more, a breach of those implied or express duties can give rise only to a cause of action in contract, not one in tort." *Beck v. Farmers Ins. Exch.*, 701 P.2d 795 (Utah 1985).

44. 691 P.2d 1138, 1141 (Colo. 1984).

45. *Id.* at 1141.

46. *Noble v. National Am. Life Ins. Co.*, 624 P.2d 866, 867-868 (Ariz. 1981) (citing *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368, 376-77 (Wis. 1978)). The *Noble* court held that "[u]nder the *Anderson* standard an insurance company may still challenge claims which are fairly debatable. The tort of bad faith arises when the insurance company intentionally denies, fails to process or pay a claim without a reasonable basis for such action." 624 P.2d at 868.

47. For example, according to the court in *McCullough v. Golden Rule Ins. Co.*, 789 P.2d 855, 859-860 (Wyo. 1990), bad faith was an intentional tort and "the appropriate test to determine bad faith is the objective standard whether the validity of the denied claim was not *fairly debatable*." *Id.* at 860 (emphasis added). The Iowa Supreme court ruled that "[w]here a claim

Other supreme courts within the Fifth and Eleventh Circuits also embrace an "objective" intent standard. In those jurisdictions, however, the measure is called the "arguably-debatable" standard. Under this latter version, an aggrieved policyholder must go beyond a mere showing of nonpayment of a claim.⁴⁸ He also must prove that the insurance company intentionally refused to pay the claim.⁴⁹ Finally, the policyholder must show that the insurance company lacked a "reasonably-legitimate" or "arguably-debatable" reason for the refusal.⁵⁰

These competing intent standards are complex and provide little guidance for insurers, first-party complainants or triers of fact. A well-reasoned dissenting opinion in *Vincent v. Blue Cross-Blue Shield*⁵¹ illustrates the current confusion. There, Justices Embry asked:

What is the test for the tort of bad faith? . . . In California 'the ultimate test of liability in . . . first-party cases is whether the refusal to pay policy benefits is unreasonable. . . .' [T]he Wisconsin Supreme Court held the tort of bad faith to be an intentional one, but based its test . . . on the lack of a reasonable basis for denial of a claim. . . . Similarly, in Ohio an insured may recover upon proof

is 'fairly debatable,' the insurer is entitled to debate it, whether the debate concerns a matter of fact or law." *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790, 794 (Iowa 1988). The *Dolan* court stated that the test is an objective one and clearly establishes the intentional nature of the tort of bad faith. *Id.* The Rhode Island Supreme Court in *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313, 319 (R.I. 1980), stated that recognition of the tort of bad faith does not "imply that whenever an insurance company loses a dispute in court regarding the validity of a claim, it breaches the implied-in-law duty of good faith. If a claim is 'fairly debatable,' no liability in tort will arise." *Id.* at 319. Finally, the Wisconsin Supreme Court in *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368 (Wis. 1978), observed that "'Bad faith' by definition cannot be unintentional. 'Bad Faith' is defined as '[d]eceive; duplicity; insincerity'." *Id.* at 376 (quoting AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 471 (1969)).

48. See, e.g., *King v. National Found. Life Ins. Co.*, 541 So. 2d 502, 504 (Ala. 1989) (quoting extensively *National Sec. Fire & Casualty Co. v. Bowen*, 417 So. 2d 179 (Ala. 1982)). The *Bowen* court held:

[T]he plaintiff in a 'bad faith refusal' case has the burden of proving: (a) an insurance contract between the parties and a breach thereof by the defendant; (b) an intentional refusal to pay the insured's claim; (c) the absence of any reasonably legitimate or arguable reason for that refusal (the absence of a debatable reason); (d) the insurer's actual knowledge of the absence of any legitimate or arguable reason; [and] (e) . . . the insurer's intentional failure to determine whether there is a legitimate or arguable reason to refuse to pay the claim.

541 So. 2d at 504. See also *Blue Cross & Blue Shield, Inc. v. Campbell*, 466 So. 2d 833 (Miss. 1984). In *Campbell*, the court held that punitive damages are not available when an insurance company has an arguable or legitimate reason for denying coverage. *Id.* at 851. An arguable reason for denying payment of a claim exists if there is some credible evidence that would support a jury's conclusion that bad faith was not present.

49. *Id.*

50. *Id.*

51. 373 So. 2d 1054 (Ala. 1979)

that the insurer had no intention of paying the claim, but such intention may be demonstrated by the lack of reasonable basis for denial. . . . [But according to the tests of these other courts,] *[w]hat a reasonable insurer would do or not do is a negligence test.*⁵²

Although Justice Embry would reject the use of the negligence standard, his last comment illuminates that negligence standard.⁵³ But as the Supreme Court of Montana observed, a clear distinction between a cause of action for negligence and for bad faith does not exist. In fact, the Montana court pointed out that while differences between bad faith and negligence tests exist, in practice courts have merged the two tests.⁵⁴ More important, a careful comparison of the intent and negligence standards, within the context of a bad-faith action, shows little difference between the two measures. Under either test, a complainant must prove that an insurer's action or inaction was unreasonable.⁵⁵

Arguably, no significant difference exists between a negligence and an intent standard in the context of first-party suits. Citing the limited amount of evidence presented thus far, bad-faith litigants could reasonably conclude that state supreme courts are biased. In first-party situations, justices must articulate more precise and intelligible decisions in this area of law. By outlining definitive standards, state supreme courts would help counter the

52. *Id.* at 1067 (Embry, J., dissenting) (emphasis added and removed).

53. *Id.*; see also, *Reynolds v. American Hardware Mut. Ins. Co.*, 766 P.2d 1243 (Idaho 1988). Where a complainant asserts a negligence claim he must show, "(1) a duty, recognized by law, requiring a defendant to conform to a certain standard of conduct; (2) a breach of that duty; (3) a causal connection between the defendant's conduct and the resulting injuries; and (4) actual loss or damage." *Id.* at 1246-47 (citing *Alegria v. Payonk*, 619 P.2d 135, 137 (Idaho 1980). "An examination of the tests for bad faith devised in other jurisdictions reveals that most open the door for recoveries based on negligence." *Vincent*, 373 So. 2d at 1067.

54. *Gibson v. Western Fire Ins. Co.*, 682 P.2d 725, 731 (Mont. 1984).

55. For example, in South Carolina, a negligence rather than an intent standard has been embraced to establish the tort of bad faith. An insured may recover damages for an insurer's negligent handling of a first-party claim. But, under South Carolina law, liability will ensue only when the insurer's conduct is "unreasonable." In *Nichols v. State Farm Mut. Auto. Ins. Co.*, 306 S.E.2d 616 (S.C. 1983), the court stated:

[W]e held in *Tyger River Pine Co. v. Maryland Casualty Co.*, 170 S.C. 286, 170 S.E. 346 (1933), that an insurer's unreasonable refusal to settle within policy limits subjects the insurer to tort liability. We have held also that unreasonable refusal on the insurer's part to accept an offer of compromise settlement will render it liable in tort to the insured for the amount of the judgment against the insured in excess of policy limits. The cause of action we consider today and that which is commonly known as the 'Tyger River Doctrine,' are merely two different aspects of the same duty.

Id. at 618-19 (citation omitted). Similarly, in New Hampshire, the test for the tort of bad faith is a negligence standard. The Supreme Court of New Hampshire has ruled that a jury may review evidence to determine the "reasonableness" of the insurer's conduct, in situations where the insurer allegedly refused to pay or delayed the payment of a claim. *Drop Anchor Realty Trust v. Hartford Fire Ins. Co.*, 496 A.2d 339, 343 (N.H. 1985).

widespread impression that state courts are politically motivated.⁵⁶ A delineation of objective standards would also counter the perception that state supreme courts are more concerned about obtaining a particular result than about consistently applying legal principles.⁵⁷

III. THE INCONSISTENT APPLICATION OF LEGAL PRINCIPLES INVOLVING THIRD-PARTY INSURANCE

As noted, state supreme courts unwittingly create the impression that they are biased in favor of either the insurance industry or the consuming public. Professor Callahan, who has investigated and written about third-party insurance decisions, makes an even stronger indictment against state courts.⁵⁸ He asserts that judicial bias permeates third-party insurance decisions because state supreme courts do not apply legal rules.⁵⁹ Instead, according to Professor Callahan, the courts' use of ambiguous language, as well as the parties' use of legal jargon, influence the outcome of cases.⁶⁰ A careful review of third-party suits supports Professor Callahan's assertions, especially in light of actions brought by insureds, assignees, third-party beneficiaries, and excess insurers' actions to recover excess-judgment damages.

56. See generally, Walter Olson, *Why Business Loses in Court*, FORTUNE May 23, 1988, at 127-30 (reviewing RICHARD NEELY, *THE PRODUCT LIABILITY MESS: HOW BUSINESS CAN BE RESCUED FROM STATE COURT POLITICS* (1987)). Olson writes: "Richard Neely . . . is a modern judge. . . . [He] is no cardboard demagogue. . . . [But Neely shares] the widespread view that judges are no more than politicians in robes." *Id.* Olson concludes by suggesting that judges are more concerned about their constituents' interests than about justice. *Id.* at 130.

57. See Young, *supra* note 17, at 72-73 (stating "prevailing judicial rationales are often so camouflaged by reference to 'established rules' that it is impossible to pair a given situation with the appropriate doctrines so as to achieve a high degree of predictability").

58. Peter M. Callahan, *Some Thoughts on the Avoidance of Extra-Contractual Damages in California Insurance Litigation*, 14 W. ST. UNIV. L. REV. 73, 75-78 (1986).

59. *Id.* at 77-78.

60. *Id.*; Professor Callahan writes:

[T]here is much truth in the perception of many claims people that there are in fact, no 'rules' or concrete definition of bad faith and therefore what may result in extracontractual . . . damages in one courtroom could result in a defense verdict in a contemporaneous trial right next door, since the latter finders of fact may have a different interpretation of what actions should be deemed 'unfair.' . . . Many appellate opinions do not address themselves to any analysis of a factual context at all, but ask only if certain 'magic words' were properly pled by inventive counsel.

Id. at 79-80.

A. *Interjurisdictional Conflicts Over Whether Insureds May Recover Damages in Excess of Policy Limits*

An individual purchases liability insurance, among other reasons, to protect himself against the legitimate claims of injured third parties.⁶¹ However, when a primary carrier refuses to defend⁶² the insured or to settle⁶³ a third-party's claim against the insured within the policy limits,⁶⁴ the insured may incur excess liability,⁶⁵ which is not covered by the policy.

61. SHERNOFF, *supra* note 42, § 3.01 at 3-3. The author observes:

Nearly all insurance policies can be classified into one of two types: those that provide 'first[-]party' coverage and those that provide 'third-party coverage.' . . . [U]nder a policy providing third-party or liability coverage[,] the insured, faced with a claim by a third-party or outside claimant, seeks indemnity from his or her insurer for the claim.

Id.

62. See Robert E. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1137 (1954). Generally, liability insurance policies provide that the primary carrier shall " 'defend any suit against the insured . . . even if such suit is groundless, false or fraudulent; but the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient.' " *Id.* (footnote omitted). See also PAT MAGARICK, *EXCESS LIABILITY: THE LAW OF EXTRA-CONTRACTUAL LIABILITY OF INSURERS* (1990) [hereinafter *MAGARICK*]. Magarick asks:

How then to determine whether an insurer owes a defense to the insured if a suit is instituted against him? Generally speaking, the vast majority of decisions hold that an insurer's duty to defend is determined by the allegations in the complaint. If the allegations are covered by the terms of the policy, the duty to defend arises. If the allegations are not covered, the insurer owes no duty to defend the policyholder.

Id. § 2.01, at 2-1 (footnote omitted).

63. See *MAGARICK* and accompanying cases, *supra* note 62, § 8.03, at 8-9.

The duty to settle has been held to arise out of the entire contractual relationship of the parties since the insurance company has the right under the policy to exclusive control of the settlement of claims and suits under the provisions of the ordinary liability policy. Wrongful refusal to settle within the policy limits also has been held to be a breach of contract by some courts, while others have held that an action based on such refusal is founded in tort. Still others have held that the good faith duty to settle 'sounds both in contract and [in] tort.'

Id. (footnotes omitted).

64. See *WIDISS supra* note 1, § 5.9 at 541.

Pecuniary limits of liability are specified in most types of insurance [contracts] in order to restrict the magnitude of the risks that are transferred to the insurer. Typically, for example, one provision in a property insurance policy specifies an amount of coverage that sets the insurer's maximum liability when an insured event occurs. . . . And liability insurance is usually written with either (a) per-person and per-occurrence . . . limits of liability . . . or (b) a single limit of liability that applies both to any individual claim and to any group of claims resulting from a single occurrence.

Id. (footnote omitted).

65. The terms "excess liability" and "excess judgment" are used interchangeably in this writing. See *SHERNOFF, supra* note 42, at § 3.01 (stating that a typical liability policy gives the

Where the insurer refuses to accept a settlement within the insurance contract's limits, many cases hold a primary carrier liable for an excess judgment against the insured.⁶⁶ Both commentators and courts agree that if an indemnification agreement embraces only some of a third party's allegations, the insurance company must defend the entire suit.⁶⁷ Despite the agreement by courts on these issues, courts are divided on at least two other important issues.

First, state supreme courts generate biased and incompatible principles when they attempt to outline the origin of the insurer's duty to satisfy excess judgments against the insured. For example, the Supreme Court of Ohio has ruled that the insurance company's duty stems from its contract with the insured.⁶⁸ By contrast, both the Arkansas and Colorado supreme courts employ a negligence test to assess whether an insurer's conduct deviates from an acceptable standard of care.⁶⁹ In Colorado, the supreme court found that the negligence standard derives from the quasi-fiduciary nature of the parties' relationship.⁷⁰

The Supreme Court of New Jersey, however, has held that a fiduciary rather than a quasi-fiduciary relationship exists between an insurance company and a policyholder, especially when the company handles third-party claims.⁷¹ A carrier, therefore, breaches its fiduciary duty when it fails to defend or refuses to settle a claim within policy limits.⁷² To further complicate this area of law, several other states⁷³ have adopted a bad-faith standard

insured the *right* to defend and settle a claim; but it also "imposes a duty to defend third-party actions against the insured"). In addition Shernoff asserts:

insurers [are] obligated to act in good faith [when] determining whether . . . to settle actions against their insureds. When the insurer breaches this obligation, the insured may bring an action against the insurer for the amount of any judgment entered against the insured in excess of the policy limits. This action by the insured is commonly referred to as an 'excess[-]judgment suit.'

Id. (footnotes omitted).

66. *Commercial Union Assur. Co. v. Safeway Stores*, 610 P.2d 1038, 1040 (Cal. 1980); *see also*, *Murphy v. Allstate Ins. Co.*, 553 P.2d 584, 586 (Cal. 1976) (holding that the insurer's duty of good faith requires it to "settle within policy limits when there is substantial likelihood of recovery in excess of those limits").

67. SHERNOFF, *supra* note 42, at § 3.21[4].

68. *Centennial Ins. Co. v. Liberty Mut. Ins. Co.*, 404 N.E.2d 759, 762 (Ohio 1980) (quoting *Peter v. Travellers Ins. Co.*, 375 F. Supp. 1347, 1350 (C.D. Cal. 1974)).

69. *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138 (Colo. 1984); *Employers Equitable Life Ins. Co. v. Williams*, 665 S.W.2d 873, 874 (Ark. 1984) ("The third party tort of bad faith is the negligent failure of an insurer to settle a third party claim within the policy limits.").

70. *Farmers Group*, 691 P.2d at 1142.

71. *See Rova Farms Resort, Inc. v. Investors Ins. Co.*, 323 A.2d 495, 507 (N.J. 1974).

72. *Id.*

73. *See generally*, MAGARICK, *supra* note 62, at §§ 10.04-10.06 (discussing bad-faith standards adopted by jurisdictions in both first-and third-party claims).

to determine whether an insurer breached its duty when handling a third-party claim.⁷⁴

The second controversial issue confronting insureds who commence excess-judgment suits against primary carriers centers on when a primary carrier should compensate a policyholder for damages associated with an excess-judgment verdict. Should the insurer reimburse the policyholder only after the insured *has made a payment* to an injured third party? Or should the carrier compensate the insured *soon after an excess-judgment verdict has been entered* against the insured?

The reasonable expectation of the policyholder would effectuate a commonsensical and universal rule that the insurer must pay the insured immediately after a court enters a judgment in excess of the policy limits. Predictably, however, courts have applied more than one school of thought. Some state supreme courts have adopted the "judgment rule," which states that an entry of an excess-liability verdict alone is sufficient for an insured to recover damages from an insurer.⁷⁵ Under the judgment rule, the insured need not "allege that he has paid or will pay a judgment in excess of the policy limits in an action against the insurer."⁷⁶

On the other hand, other state supreme courts have rejected the judgment rule and embraced the "payment rule" to resolve excess-liability actions. In a recent decision, for example, the Michigan Supreme Court rejected the judgment rule after reconsidering dissenting Justice Levin's prior arguments for adopting the payment rule.⁷⁷ Instead, the court held that when a carrier fails to settle a third-party claim and the policyholder incurs a judgment in excess of policy limits, the insurer's liability for the excess is limited to the amount the third-party might collect from the insured.⁷⁸ Under the payment rule, the insured must "first make [a] payment or . . . have the capacity to pay the judgment in order to recover damages from the insurer."⁷⁹

74. The Supreme Court of Arizona has ruled that a primary carrier may avoid bad-faith liability if the carrier (1) retains competent counsel to defend the insured; (2) informs the insured of all material developments and settlement offers; (3) thoroughly investigates a claim; and (4) gives equal consideration to the interests of the insured when negotiating the claim. See *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 792 P.2d 719, 722 (Ariz. 1990) (outlining additional factors to be considered by the trier of fact in a third-party bad faith claim).

75. See, e.g., *Carter v. Pioneer Mut. Casualty Co.*, 423 N.E.2d 188, 190-91 (Ohio 1981) (adopting the "judgement rule" and citing cases from other states).

76. *Id.* at 190 n.2. (quoting *Jenkins v. General Accident Fire Life Assur. Corp.*, 212 N.E.2d 464, 467 (Mass. 1965)).

77. *Frankenmuth Mut. Ins. Co. v. Keeley*, 461 N.W.2d 666 (Mich. 1990).

78. *Id.* at 667.

79. *Id.* at 668 (Archer, J., dissenting). Justice Archer reminded the *Frankenmuth* court that it had "held that when an insurer's bad-faith refusal to settle results in a judgment in excess of its policy limits, the measure of damages is the amount of the excess judgment." *Id.*

The most disturbing feature concerning the conflict between the judgment and payment rules stems from the refusal of state supreme courts to articulate persuasive and intelligible reasons for adopting these and other rules of recovery. Instead, state tribunals simply conclude that the judgment rule is more or less superior to the payment rule. In other words, such behavior lends credence to what a number of scholars and commentators believe: state supreme courts have hidden political agendas, and the justices are biased either in favor of the insurance industry or in favor of the consumers.⁸⁰

B. Interjurisdictional Conflicts Over Whether Assignees May Recover Damages in Excess of Policy Limits

State courts are also divided as to whether assignees may recover damages in excess of policy limits. When a carrier refuses to settle or defend against a third-party claim, the insured is often exposed to liability in excess of the policy limits. To remedy this unjust situation, some states permit the insured to commence a bad-faith tort action against the carrier to recover excess damages.⁸¹ But often the disgruntled policyholder and the injured third party enter an agreement to settle their excess-liability conflict. Under the agreement, the insured agrees not to sue his primary carrier. Instead, the aggrieved policyholder assigns his bad-faith tort action to the injured party. The third-party victim agrees to sue the insurer directly for the excess judgment and to release the insured from liability.

Presently, state supreme courts disagree over whether to allow the assignment of a bad-faith tort claim in these circumstances. It is disturbing that cases involving such a controversy are still appearing in state supreme courts, consuming these tribunals' limited resources and time. As most first-year law students discover, the common-law is fairly settled on one point: *personal-injury tort claims are not assignable*.⁸² Nonetheless, most courts, presently refuse to adhere to this strict principle of law.⁸³ The majority of

Justice Archer also informed the court that they had rejected the insurance company's argument "that an insured is injured and incurs pecuniary losses recoverable as contract damages only by paying or having the ability to pay the judgment." *Id.* He closed by reminding the majority that "[w]e reasoned that, in the bad-faith failure-to-settle context, the insured's injury and right to compensation should not turn upon his financial status, but rather upon the consequences flowing from the excess judgment itself." *Id.*

80. See *supra* notes 9-31 and accompanying text.

81. See *supra* notes 74-75.

82. Cf. *Mello v. General Ins. Co.*, 525 A.2d 1304, 1305 (R.I. 1987) (citing *Etheridge v. Atlantic Mut. Ins. Co.*, 480 A.2d 1341, 1345 (R.I. 1984)).

83. The Supreme Court of Kansas, however, follows this principle. "[A] right of action for damages resulting from a tort is not assignable;" the party commencing the suit must "own the cause of action" and be "a real party in interest." *Heinson v. Porter*, 772 P.2d 778, 783-85 (Kan. 1989), *overuled in part on other grounds*, *Glenn v. Fleming*, 799 P.2d 79 (Kan. 1990)

state supreme courts are not indifferent to the evils of champerty and maintenance, but it appears that they are more concerned about satisfying the reasonable expectations of an aggrieved policyholder. Moreover, if sanctioning the assignment of a tort claim for excess damages satisfies those expectations, courts will allow the assignment.⁸⁴

It should be fairly evident that these supreme court rulings are not beneficial. They fail to provide a sound methodology that would help litigants decide whether their claims qualify as one of those "limited circumstances" where assignment is allowed. More pertinently, by departing from settled law,⁸⁵ without providing intelligible or compelling reasons for the deviation, state supreme courts lend support to the view that state courts are biased against the insurance industry. As one commentator observed:

(quoting *Star Mfg. Co. v. Mancuso*, 680 F. Supp. 1496, 1498-99 (D. Kan 1988)). Apparently, third parties who attempt to collect excess-judgment damages do not fall into either category. More important, it appears that the Supreme Court of Kansas is concerned about the twin evils of champerty and maintenance because it has clearly stated that "[t]ort claims are personal in nature and third parties should not be permitted to buy claims for personal injuries and losses." *Id.* at 785. In fact, the court characterizes such third-party actions as "the traffic of merchandising in quarrels [and] of huckstering litigious discord." *Id.* at 784.

It appears that the Supreme Court of Tennessee also has a similar concern because it has ruled that a tort action is not assignable in Tennessee. *Dillingham v. Tri-State Ins. Co.*, 381 S.W.2d 914, 918 (Tenn. 1964). Quoting from a Harvard Law Review article, the court observed:

A doctrine or statute permitting [a third-party] claimant to recover the excess from [a] company, either in his own right or as assignee of insured, is only slightly beneficial to insured—the one who is the victim of [the] company's wrong. [The] [i]nsured is protected by the cause of action for reimbursement. . . . The person greatly benefited by such doctrine is [the third-party] claimant—a person not harmed by [a] company's refusal to settle. A judicial extension (either by tort or by implied contract theory) of the liability of [a] company beyond that undertaken by the agreement cannot be justified by a purpose of benefiting a third party who is not harmed by anything [the] company has done or failed to do.).

Id. (quoting Keeton, *supra* note 62, at 1176-77).

84. Some support for this line of reasoning appears in a recent decision from the Supreme Court of Rhode Island. In *Mello* the court states vigorously:

'We do not reject the general prohibition against the purchasing of personal-injury claims by intermeddling volunteers for their own profit. [But] [w]e simply cannot allow a salutary rule to be applied in a context in which it has no meaning and thereby obstruct an appropriate device for the payment of a claim by an insurance carrier that has an obligation to its insured to absolve him of liability. . . .' While we do not advocate a general policy of allowing assignment of the right to sue an insurance company for bad faith, we are convinced that in certain limited circumstances the insured's right may be assigned.

525 A.2d at 1306 (quoting *Etheridge*, 480 A.2d at 1345).

85. See, e.g., *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 202 (Cal. 1958) (holding action for damages is assignable whether sounding in tort or contract); *Pietrantonio v. Travellers Ins. Co.*, 275 N.W. 786, 788 (Mich. 1937) (stating that the executor could assign a policy to an injured passenger in automobile accident).

It is pretty obvious that . . . assignments, conditioned on a release of further liability for the insured, have all of the appearances of collusion between the insured and the plaintiff to team up against the insurer. It is, in fact, hard to imagine a situation where such an agreement could be made without some very fine-line discussions between the parties. Nevertheless, the courts have consistently looked at this situation with glazed eyes.⁸⁶

C. *Interjurisdictional Conflicts Over Whether Third-Party Beneficiaries and Judgment Creditors May Recover Damages in Excess of Policy Limits*

Both third-party beneficiaries and judgment creditors⁸⁷ must confront inconsistently applied theories of recovery in excess-damages suits. This is true even though third-party beneficiaries and creditors have been the subject of considerably less litigation in state supreme courts than insureds.⁸⁸

Liability insurance is purchased primarily to recompense injured third parties.⁸⁹ Therefore, one would expect such parties to have little difficulty obtaining the right to commence direct-action suits against liability carriers for extracontractual damages. Yet, a critique of relevant state supreme court decisions reveals much disagreement over the legal right of third parties to sue an insurer for excess damages.

Rather than allowing a third-party claimant to go uncompensated or to "drive the insured into bankruptcy, courts have permitted the third-party claimant to recover directly against the insured upon a third-party benefi-

86. MAGARICK, *supra* note 62, at § 9.02.

87. Arguably, within the context of insurance suits for excess damages, a judgment creditor is a third-party beneficiary. Blacks Law Dictionary defines a "judgment creditor" as "one who has obtained a judgment against his debtor, under which he can enforce execution." BLACK'S LAW DICTIONARY 844 (6th ed. 1990) Of course, this definition does not apply to a third party who has been injured by an insured. But, the same dictionary defines a "third party beneficiary" as "a person not a party to an insurance contract who has legally enforceable rights thereunder." *Id.* at 1480. Certainly, this latter definition includes a judgment creditor. Several cases support this position. See *First Nat'l Bank v. Higgins*, 357 S.W.2d 139 (Mo. 1962); *Homan v. Employers Reins. Corp.*, 136 S.W.2d 289 (Mo. 1939). Both *Homan* and *First Nat'l Bank* construed treaties of reinsurance as contracts of indemnity against liability. These courts deemed judgment creditors as third party beneficiaries. Nevertheless, this Article considers these groups separately.

88. *Kranzush v. Badger State Mut. Casualty Co.*, 307 N.W.2d 256, 262 (Wis. 1981).

89. See *supra* note 63 and accompanying text; see also *Metropolitan Life Ins. Co. v. McCarron*, 467 So. 2d 277, 279 (Fla. 1985) (holding that the "insurer contracts to bear the insured's financial responsibility to the intended third-party beneficiary"). But see PROSSER, HANDBOOK OF THE LAW OF TORTS 544 (1971) ("Since, in its inception, liability insurance was intended solely for the benefit and protection of the insured, which is to say the tortfeasor, it followed that the injured plaintiff, who was not a party to the contract, had at common law no direct remedy against the insurance company") (emphasis added).

ary theory."⁹⁰ The absence of privity of contract has not been a bar to such actions. For example, in *Thompson v. Commercial Union Insurance Co.*,⁹¹ the Florida Supreme Court held that a third party may sue the insurance carrier directly for failure to settle. According to the court, the implied duty of good faith and fair dealing also protects an injured third party from a carrier's intransigence. Therefore, a few courts view a suit to recover extracontractual damages as a proper remedy for an unwarranted breach of the duty.⁹²

Conversely, other supreme courts⁹³ adopt the view that no privity of contract exists between an offending insurance company and an injured third party. Therefore, a third party may not commence a direct action against a liability carrier for damages in excess of the policy limits. In Idaho, this direct-action rule has been applied consistently in a string of insurance cases⁹⁴ prefaced on a third-party beneficiary theory.

For example, in *Downing v. Travelers Insurance Co.*,⁹⁵ the Idaho Supreme Court held that a deceased train engineer's wife could not maintain a direct action against the liability insurer on the theory that she was a third-party beneficiary under a group liability policy for union members. The court found that various collective-bargaining agreements had forced the employer to purchase liability insurance specifically for union members. Because the petitioner could not establish a right to any death benefits under the agreements, the court barred her from suing the carrier directly as a third-party beneficiary.⁹⁶

90. *Kranzush*, 307 N.W.2d at 262.

91. 250 So. 2d 259 (Fla. 1971).

92. *Id.* at 261-64.

93. *See, e.g.*, *Severson v. Estate of Severson*, 627 P.2d 649 (Alaska 1981); *Pocatello Indus. Park Co. v. Steel West, Inc.*, 621 P.2d 399 (Idaho 1980); *Miller v. Market Men's Mut. Ins. Co.*, 115 N.W.2d 266 (Minn. 1962); *see also*, *Manukas v. American Ins. Co.*, 237 A.2d 898 (N.J. 1968).

94. *See Hettwer v. Farmers Ins. Co.*, 797 P.2d 81, 82 (Idaho 1990); *Downing v. Travellers Insurance Company*, 691 P.2d 375, 378 (Idaho 1984); *Pocatello*, 621 P.2d at 407.

95. 691 P.2d at 378.

96. *Id.* at 378-79. The Idaho Supreme Court tells us:

This is a direct action against an insurer, by a party not a party to the insurance contract. The situation here is similar to a case where A injures B, B has a liability insurance policy with C, and A attempts to sue C directly to recover benefits under the policy. This type of direct action has never been recognized. Here, by attempting to maintain the action against the insurance company, without first establishing entitlement to any death benefits under the collective bargaining agreement, appellant is attempting to circumvent the requirement that she establish a right under the death benefit provision of the collective bargaining agreement. Appellant's claim is based upon the death benefit provision of the collective bargaining agreement. Appellant should not be allowed to sue the insurance company directly any more than a tort victim injured in an automobile accident should be able to directly sue the insurer.

Not surprisingly, state supreme courts also apply rules inconsistently in third-party cases where judgment creditors attempt to bring direct actions against insurers. But the overwhelming weight of authority holds that an aggrieving, excess-judgment creditor cannot commence such direct actions.⁹⁷ There are several competing explanations⁹⁸ of why some state supreme courts reject third-party claims against liability carriers for sums in excess of the policy limits.⁹⁹ The majority of courts deny recovery because (1) the insured alone bears the obligation of settling, (2) the third-party judgment creditor has suffered no injury in fact, and (3) the judgment creditor is not a party to the contract between the policy holder and the insurance company.¹⁰⁰ A common theme is present here: absent privity of contract or an assignment, an injured judgment creditor may not initiate a direct action against a carrier to collect excess-judgment damages.¹⁰¹

Of course, courts in Montana and in Kansas refuse to embrace this point of view. In fact, the Supreme Court of Montana has adopted an extremely divergent position: "After judgment against the insured, the [judgment creditor] . . . is in the same position as an insured with respect to the insurance company. *The contractual duties that exist . . . are protected by the same concepts of good faith and fair dealing that pertain to contracts between insurers and insureds.*"¹⁰²

The holding of the Kansas Supreme Court in *Gilley v. Farmer*¹⁰³ is both exceptional and unsettling because the court's analysis is undeniably and unnecessarily complex. In *Gilley*, an injured judgment creditor brought a direct, bad-faith action against the insured's liability carrier to recover

ance carrier of the tortfeasor without having first proved a claim against the tortfeasor individually.

Id. (citations omitted).

97. See *Kranzush v. Badger State Mut. Casualty Co.*, 307 N.W.2d 256, 262-63 (Wis. 1981).

98. See, e.g., *supra* text accompanying notes 90-92; see also *Rutter v. King*, 226 N.W.2d 79 (Mich. 1974) (recognizing claim of third-party judgment creditor in a garnishment proceeding); *Gilley v. Farmer*, 485 P.2d 1284 (Kan. 1971) (granting relief to a judgment creditor in a garnishment action); *Shaw v. Botens*, 403 F.2d 150 (3d Cir. 1968) (involving a garnishment action by a judgment creditor).

99. *Kranzush*, 307 N.W.2d at 263.

100. *Id.*

101. See, e.g., *Bean v. Allstate Ins. Co.*, 403 A.2d 793, 794-96 (Md. 1979) (holding that the insurer owed no duty to the third-party judgment creditor because there was no privity of contract between the claimant and the liability insurance carrier).

102. *Montana ex rel. Fitzgerald v. District Court*, 703 P.2d 148, 158 (Mont. 1985) (emphasis added). The court also stated that "the contractual right of a third party claimant to sue the insurer directly after judgment must include the right to receive payment of the determined third party claim after judgment." *Id.*

103. 485 P.2d 1284 (Kan. 1971).

damages in excess of the policy limits. The court considered whether a garnishment proceeding was an appropriate vehicle for remedying the claim of an aggrieved third party for extracontractual damages.¹⁰⁴ The Kansas court answered the question affirmatively, but its inordinately complicated analysis suggests that the court was biased against the insurance company.

The Kansas Supreme Court observed that the state's garnishment statute failed to specify the types of indebtedness claims open to garnishment; rather the statute only outlined an exception for noncontractual claims.¹⁰⁵ Moreover, the court declared that the exception applies only to unliquidated tort claims.¹⁰⁶ But the defending insurance company argued this very point. The company maintained that whatever cause of action the aggrieved third party may have had to recover extracontractual damages, the action was grounded in tort. From the carrier's perspective, the claim fell within the exception and, therefore, was not subject to garnishment.¹⁰⁷

The Kansas court admitted that other supreme courts supported the liability carrier's argument, but stressed that those authorities provided no precedent for its deliberations.¹⁰⁸ More significantly, the court asserted that an implied warranty for service existed between the insurer and the insured¹⁰⁹ and that a breach of the implied warranty permits an insured to commence an action in tort or in contract.¹¹⁰ In addition, the court stressed that the law of garnishment is settled in Kansas: "The creditor takes the place of the debtor The former takes only that which the latter could enforce."¹¹¹

104. *Id.* at 1288.

105. *Id.* at 1289. The Kansas garnishment statute states that "[n]o judgment shall be rendered in garnishment by reason of the garnishee . . . holding moneys on a claim *not arising out of contract and not liquidated* as to amount." *Id.* (quoting KAN. STAT. ANN. § 69-724 (1983)) (emphasis added).

106. *Id.*

107. *Id.*

108. *Id.* (citing *Pringle v. Robertson*, 465 P.2d 223 (Or. 1969) (holding that a judgment creditor may not attach an insured's tort claim against an insurer); *Steen v. Aetna Casualty & Surety Co.*, 401 P.2d 254 (Colo. 1965) (upholding the dismissal of a garnishment action brought by judgment creditor), *Dillingham v. Tri-State Ins. Co.*, 381 S.W.2d 914 (Tenn. 1964) (denying a judgment creditor the right to maintain an action against an insurer for an amount in excess of policy limits); *Murray v. Mossman*, 355 P.2d 985 (Wash. 1960) (holding that a garnishment procedure was not available to judgment creditors in an action brought against insurance company); *Stilwell v. Parsons*, 145 A.2d 397 (Del. 1958) (denying a judgment creditor the right to bring a garnishment proceeding against an insurance carrier); *Paul v. Kirken-dall*, 311 P.2d 376 (Utah 1957) (interpreting a garnishment statute to exclude pure tort claims).

109. *Gilley*, 485 P.2d at 1289.

110. *Id.*

111. *Id.* at 1290.

Because the policyholder had a right to sue the liability carrier in a garnishment proceeding,¹¹² an injured judgment creditor has that same right.¹¹³

Gilley is particularly troublesome because the court failed to follow precedent. To circumvent its own holding that unliquidated tort actions are barred from garnishment proceedings,¹¹⁴ the Supreme Court of Kansas revised the character of the third-party's complaint. The judgment creditor had filed a direct, bad-faith tort action. Nonetheless, the court conveniently ignored that important fact and redefined the case as a breach of an implied contract action. To make matters worse, the court reiterated an exceedingly bad legal principle: "[A judgment creditor's] *petition need not state whether his action is based upon implied contract or tort.*"¹¹⁵ Thus, until Kansas and other supreme courts stop issuing such strained decisions, all litigants—policyholders, primary carriers, assignees, third-party beneficiaries and judgment creditors—will continue to question these tribunals' competence to decide bad-faith and excess-liability cases predictably and fairly.

D. *Interjurisdictional Conflicts Over Whether Excess Insurers May Recover Damages in Excess of Policy Limits*

Excess insurance emerges in two forms. First, the primary policy may provide for excess coverage through an "other insurance" clause.¹¹⁶ Second, added coverage may be secured by purchasing a second policy. This latter form, commonly referred to as an "umbrella" or an "excess" policy,¹¹⁷ pro-

112. *Bollinger v. Nuss*, 449 P.2d 502, 504 Syl § 2 (Kan. 1969) ("In this jurisdiction a liability insurer may be held liable in excess of its undertaking under the policy if it acts negligently or in bad faith when considering offers to compromise the claim against the insured for an amount within policy limits").

113. *Gilley*, 485 P.2d at 1290 ("In the present garnishment action [the creditor] is wearing the shoes of [the insured.]")

114. The court's failure to address this important issue is unfortunate because there is little guidance for subsequent cases in which the liquidation issue appears. Moreover, this case presented the Court with a good opportunity to decide the liquidated issue because both parties argued the issue in the briefs. *Id.* at 1289-90.

115. *Id.* at 1289 (emphasis added).

116. See EMERIC FISCHER & PETER N. SWISHER, PRINCIPLES OF INSURANCE LAW 96-97 (1986) [hereinafter FISCHER & SWISHER] ("The first type might be called excess insurance by coincidence, which occurs when the insured purchases two or more policies in the same insurable risk under the mistaken belief that he can receive double or triple recovery for the insured loss, in violation of insurance law indemnity principles").

117. See, MAGARICK, *supra* note 62, at § 17.01. Magarick explains:

Excess or umbrella policies are those that assume coverage for an insured above the limits of primary or other excess policies. An insured may have several excess policies, each with its own underlying requirements and with layer limits of liability. . . . Their common feature is that each insurer over the primary underlying one is not obligated to pay a loss or claim until the limit of liability of the policy for the layer immediately below it is paid, or has been agreed to be paid.

vides for "true"¹¹⁸ excess coverage after an insured has exhausted all benefits outlined in the policy-limits provision of the excess policy. Thus, after a primary carrier pays its full limits of liability to an injured third party, the excess policy requires the excess insurer to contribute any additional sums up to the limits of liability specified within the insurance contract.

A primary liability carrier frequently refuses to settle a financial dispute within policy limits or to defend actions involving injured third parties. This type of conduct subjects the insured to liability in excess of policy limits.¹¹⁹ Under such circumstances, the question arises whether the excess insurer must attempt either to settle or defend the case to prevent the insured from incurring additional, extracontractual liability.

Among state supreme court rulings, the law governing an excess insurer's obligations is settled: An excess insurer's duty to assist in an insured's defense arises when the insured exhausts the benefits of the primary policy.¹²⁰ Moreover, even after an excess insurer's duty to participate is triggered, the primary insurance company remains liable for expenses relating to its coverage.¹²¹

Nevertheless, two issues arise where the excess insurer incurs expenses from defending an underlying third-party suit or pays extracontractual damages generated by the primary carrier's decision not to settle within policy

Id.

118. FISCHER AND SWISHER, *supra* note 116, at 97 (defining an "umbrella polic[y] [as] 'true' excess insurance over the primary insurer's limit since it is the express intent of the insured, the primary insurer, and the excess insurer to provide this coverage").

119. *See supra* notes 63-67.

120. *See, e.g.,* Nabisco, Inc. v. Transport Indem. Co., 192 Cal. Rptr. 207, 209 (Cal. Ct. App. 1983); Signal Co., Inc. v. Harbor Ins. Co., 612 P.2d 889, 896 (Cal. 1980); Olympic Ins. Co. v. Employers Surplus Lines Ins. Co., 178 Cal. Rptr. 908, 912 (Cal. Ct. App. 1981). *But see*, Capital Ford Truck Sales, Inc. v. United States Fire Ins. Co., 349 S.E.2d 201, 205 (Ga. Ct. App. 1986), *rev'd on other grounds*, 355 S.E.2d 428 (Ga. 1987), *and vacated*, 360 S.E.2d 78 (Ga. Ct. App. 1987). The court reviewed Georgia law and stated:

Although most of the cases dealing with the respective duties of the primary and the excess insurer concern either disputes between insurers of two different vehicles or two different drivers . . . , the principle is the same: [I]f the facts bring the occurrence wholly, partially, or even arguably within the policies' coverage, then each insurer (whether primary or otherwise) has a duty to defend the action, regardless of whether liability, in whatever amount, is ultimately established.

Id.; *see also* Dochod v. Central Mut. Ins. Co., 264 N.W.2d 122, 123 (Mich. App. 1978) (imposing on an insurer the "duty to defend if the complaint alleges facts constituting a cause of action"); Lees v. Smith, 363 So. 2d 974 (La. Ct. App. 1978); Seaboard Indus. v. Monaco, 392 A.2d 738 (Pa. Super. Ct. 1978).

121. *See, e.g.,* Nabisco, 192 Cal. Rptr. at 210; Aetna Casualty & Sur. Co. v. Certain Underwriters, 129 Cal. Rptr. 47, 56-57 (Cal. Ct. App. 1976); *see also* Emscor, Inc. v. Alliance Ins. Group, 804 S.W.2d 195, 198-99 (Tex. Ct. App. 1991) (holding that "excess liability insurers have no duty to defend an insured in the event of the insolvency of the insured's primary general liability carrier").

limits. First, it is unclear whether the excess insurer may commence a direct action against the primary insurer to recover damages for bad faith. Second, it is equally uncertain whether the excess carrier may maintain a direct action against the primary carrier for the latter's failure to settle and/or defend¹²² a liability suit.

State supreme court decisions disagree about the merits of allowing an excess insurer to commence a direct-action suit against the primary carrier under the conditions outlined above. Many of these decisions are not well-reasoned. Instead they are quite strained, reinforcing this Article's thesis that state court decisions create the impression that judges are either pro-consumer or pro-insurer.

A few state courts, for example, have held that the relationship between the two carriers creates an implied duty of good faith and fair dealing that flows directly and independently from the primary carrier to the excess insurer; therefore, the excess carrier may commence a direct action against the primary carrier.¹²³ This rule, however, is particularly troublesome, because courts have failed to identify both the origin and the character of the relationship which would justify an independent, direct action. Typically, an excess and a primary insurer do not enter a *liability* contract,¹²⁴ so the prerequisite legal affiliation could not possibly emanate from a contractual ar-

122. See *Capital Ford*, 349 S.E.2d at 205 (holding that under Georgia law, "an insurer's duty to pay and his duty to defend are separate and independent obligations"); *Palmer v. Pacific Indem. Co.*, 254 N.W.2d 52, 54-55 (Mich. Ct. App. 1977) (holding that the duty to defend is broader than the duty to pay); *Ladner & Co. v. Southern Guar. Ins. Co.*, 347 So. 2d 100, 102 (Ala. 1977) (stating "that the insurer's duty to defend is more extensive than its duty to pay."); *Sloan Constr. Co. v. Central Nat'l Ins. Co.*, 236 S.E.2d 818, 820 (S.C. 1977) (finding that "[t]he duty to defend is separate and distinct from the obligation to pay a judgment rendered against the insured").

123. See *Maine Bonding & Casualty Co. v. Centennial Ins. Co.*, 693 P.2d 1296, 1302 n.5 (Or. 1985) ("Some courts have held that the excess carrier's right of recovery is supportable on the theory that the relationship between the primary insurer and the excess insurer gives rise to an independent duty."); see also *Commercial Union Ins. Co. v. Medical Protective Co.*, 356 N.W.2d 648, 651 (Mich. Ct. App. 1984), *aff'd in part and remanded in part*, 393 N.W.2d 479 (Mich. 1986) ("a direct action is justified where . . . the excess insurer is the real party in interest."); *Hartford Accident & Indem. Co. v. Michigan Mut. Ins. Co.*, 463 N.E.2d 608, 610 (N.Y. 1984) (citation omitted) ("Moreover, Michigan Mutual as the primary liability insurer owed to Hartford as the excess carrier the same duty to act in good faith which Michigan owed to its own insureds."); *Russo v. Rochford*, 472 N.Y.S.2d 954, 959 (N.Y. App. Div. 1984) ("[t]he precedential value of the direct duty theory to Allstate, as excess carrier, is that its rights and interest will not necessarily be dependent upon the conduct of Robert Clemente, the insured, in exercising his obligation to cooperate with the primary insurer in his defense"); *MAGARICK*, *supra* note 62, at § 17.01.

124. See T. Richard Kennedy, *Good Faith Principles Judicially Imposed in Dealings Between Primary and Excess Insurers and Reinsurers*, 26 *TORT & INS. L.J.* 590, 591 (1991). Notably, these carriers do negotiate and enter contracts of reinsurance. See, e.g., *MAGARICK*, *supra* note 62, at § 17.01 (distinguishing excess insurance contracts from reinsurance policies).

rangement. But this critical point has not deterred some tribunals from allowing direct-action suits. Apparently, where courts have been unable to identify the specific source and nature of the relationship, they canvass a smorgasbord of legal jargon—such as “real party in interest” and “public policy”—to uncover other reasons to justify their improbable direct-action rulings.¹²⁵

Of course, other state supreme courts do permit a disgruntled excess carrier to recover extracontractual damages from a primary insurer on the theory of equitable subrogation.¹²⁶ In fact, nearly all courts considering this issue have held that equitable subrogation principles require the primary carrier to act responsibly toward the excess insurer as if the latter were the insured.¹²⁷ Courts adopting this rule disagree over the subissue of whether

125. See, e.g., *Commercial Union Ins. Co.*, 356 N.W.2d at 651 (finding that the “judgment creditor was a real party in interest and public policy dictated the allownace of a direct cause of action”).

126. See *Transit Casualty Co. v. Spink Corp.*, 156 Cal. Rptr. 360, 365 (Cal. Ct. App. 1979) (“Equitable subrogation is a descendant of historic equity practice; it is utilized as a device to achieve a just result by clothing a party with a right of recovery when he would otherwise be defeated by lack of privity.”), *overruled on other grounds* by *Commercial Union Assur. Co. v. Safeway Stores, Inc.*, 610 P.2d 1038 (Cal. 1980); *Meyer Koulish Co. v. Cannon*, 28 Cal. Rptr. 757, 760 (Cal. Dist. Ct. App. 1963); see also Anthony M. Lanzone and Stephen G. Ringel, *Duties of a Primary Insurer to an Excess Insurer*, 61 NEB. L. REV. 259, 263-69 (1982) (same).

127. See *MAGARICK*, *supra* note 62, at § 17.04 (“It is . . . almost universally accepted that the primary carrier owes the same duty of good faith to the excess insurer by way of equitable subrogation”); *SHERNOFF*, *supra* note 42, at § 2.03[3][c] (“[T]he primary insurer’s duty to act in good faith toward an excess insurer is generally the same as the duty owed by the primary insurer to the insured, on the theory that the excess insurer is ‘in the shoes’ of the insured.”).

the "transfer-of-rights-and-duties"¹²⁸ or the "triangular reciprocity"¹²⁹ approach should dictate when an excess carrier can recover against the primary insurer.

The Supreme Court of California, for instance, has adopted the "transfer rule." In *Commercial Union Assurance Cos. v. Safeway Stores, Inc.*,¹³⁰ the court observed that an excess carrier should be able to assert claims against a primary carrier from whom an insured would have been able to recover.¹³¹ In *Transit Casualty Co. v. Spink Corp.*,¹³² a California appellate court proffered the triangular reciprocity approach. The court recognized a tripartite duty of due care among the policyholder, the primary insurer, and the excess

128. See, e.g., *Puritan Ins. Co. v. Canadian Universal Ins. Co.*, 775 F.2d 76, 82 (3rd Cir. 1985) (applying the Pennsylvania law of equitable subrogation); *Hartford Accident & Indem. Co. v. Aetna Casualty & Sur. Co.*, 792 P.2d 749, 754 (Ariz. 1990) (en banc) ("an excess carrier is subrogated to the rights of the insured and has a cause of action against the primary insurer This right is derivative of the contract between the insured and the primary carrier. . . . As subrogee, the excess insurer's rights are no greater than the insured's") (citations and footnote omitted); *Continental Casualty Co. v. Reserve Ins. Co.*, 238 N.W.2d 862, 864 (Minn. 1976) (holding that "an excess insurer is subrogated to the insured's rights against a primary insurer for breach of the primary insurer's good-faith duty to settle"); *Estate of Penn v. Amalgamated Gen. Agencies*, 372 A.2d 1124, 1127 (N.J. Super. Ct. App. Div. 1977) (holding that a primary insurer owes a duty to an excess carrier to negotiate a settlement within the policy's limits); *Home Ins. Co. v. Royal Indem. Co.*, 327 N.Y.S.2d 745, 747-48 (N.Y. App. Div.), *aff'd* 332 N.Y.S.2d 1003 (N.Y. App. Div. 1972) (same); *Centennial Ins. Co. v. Liberty Mut. Ins. Co.*, 404 N.E.2d 759, 762 (Ohio 1980) (holding that "an excess insurer is subrogated to the insured's rights against a primary insurer and may maintain an action for breach of the primary carrier's good faith duty to settle and defend"). In *Maine Bonding & Casualty Co. v. Centennial Ins. Co.*, 693 P.2d 1296 (Or. 1985), the court stated:

If the insured purchases excess coverage, he in effect substitutes an excess insurer for himself. It follows that the excess insurer should assume the rights as well as the obligations of the insured in that position. . . . [T]he rule is this: A primary insurer owes an excess insurer essentially the same duty of due diligence in claims handling and settlement negotiating it owes to an insured—due care under all the circumstances.

Id. at 1301-02 (footnote omitted).

129. See *infra* notes 132-33 and accompanying text.

130. 610 P.2d 1038 (Cal. 1980).

131. *Id.* at 1041. The court reasoned:

Since the insured would have been able to recover from the primary carrier for a judgment in excess of policy limits caused by the carrier's wrongful refusal to settle, the excess carrier [who paid the extracontractual damages] stands in the shoes of the insured and should be permitted to assert all claims against the primary carrier which the insured himself could have asserted.

Id. (citation omitted) The California court also rejected the independent, direct-action approach by asserting that the equitable-subrogation transfer rule "does not rest upon the finding of any separate duty owed to an excess insurance carrier." *Id.*

132. 156 Cal. Rptr. 360 (Cal. Ct. App. 1979).

insurer as a basis for the excess carrier's recovery against both the primary carrier and the insured.¹³³

Only a small minority of state supreme courts have recognized the merits of the triangular reciprocity approach. A careful reading of both California and Michigan Supreme Court decisions indicates that these courts have tacitly approved this method of resolving bad-faith conflicts between liability carriers.¹³⁴ In any event, the current state of the law presents a major problem for excess carriers in California because the appellate courts continue to employ both approaches to resolve bad-faith controversies.

Finally, at least one state supreme court has held that the standard subrogation clause in a liability policy permits an excess carrier to commence a bad-faith tort action against the primary insurer. In *Allstate Insurance Co. v. Reserve Insurance Co.*,¹³⁵ the excess insurer sued the primary insurer to recover extracontractual damages resulting from the primary carrier's alleged negligent failure to settle within the underlying primary policy limits. The Supreme Court of New Hampshire stated that "Allstate is entitled to bring an action against Reserve on the basis of [the] assignment [subrogation] clause."¹³⁶ However, in the same decision, the court also maintained that they did not perceive a "relationship between the two insurers which would

133. *Id.* at 365-67. The *Spink* court found:

as an indispensable element of the excess carrier's claim, equitable subrogation fails to achieve evenhanded justice. . . . The buyer of separate primary and excess coverage generally occupies relationships with two (or more) carriers. . . . They are . . . fully aware of their respective roles and of the significant differences in their obligations to the insured for which greater or lesser premiums are charged. When an accident occurs, they become totally aware of each other. . . . Each has a choice of mutual support or naked self-interest. The law, then, would be unrealistic in demanding that either carrier use the policyholder as its stepping stone to the assertion of a mutual obligation to each other. Triangular reciprocity is far more rational.

Id. at 365. The court concluded that "[t]riangular reciprocity advances the public interest in extrajudicial settlement." *Id.* at 367. See also Michael D. Gallagher and Edward C. German, *Resolution of Settlement Conflicts Among Insureds, Primary Insurers, and Excess Insurers: Analysis of the Current State of the Law and Suggested Guidelines for the Future*, 61 NEB. L. REV. 284, 335-38 (1982); THEODORE J. TUCCI, Note, *Primary and Excess Insurers and Their Common Insured: The Triangular Relationship With No Love Lost*, 32 CASE W. RES. L. REV. 265, 291-96 (1981).

134. Compare *Commercial Union Ins. Co. v. Medical Protective Co.*, 393 N.W.2d 479 (Mich. 1986), where the court noted that "when the California Supreme Court affirmed the decision in *Safeway*, it adopted the opinion of the Court of Appeals, but deleted that portion of the Court of Appeals opinion which criticized *Spink's* recognition of triangular reciprocity." *Id.* at 484. The court concluded "that the California Supreme Court has not ruled upon the *Spink* doctrine of 'triangular reciprocity.'" *Id.*

135. 373 A.2d 339 (N.H. 1976).

136. *Id.* at 340. The court reasoned that while "[o]ther courts have sustained the right of excess insurers to maintain an action against the primary carrier under a theory of equitable subrogation, . . . [w]e find it unnecessary to utilize a subrogation analysis in view of our rule

impose *directly* upon Reserve a duty to exercise due care with regard to Allstate."¹³⁷

The Supreme Court of New Hampshire's dual holding in *Allstate* is peculiar for two reasons. First, the court's failure to find the prerequisite relationship between the primary and excess carriers—which would have permitted the latter insurer to commence a direct, independent negligence action—ignores reality. More than likely, a commonsensical interpretation of the standard subrogation clause would support this proposition: The very presence of a subrogation clause in an underlying insurance contract imposes an implied duty of good faith and fair dealing upon the primary carrier to protect the interests of a potential subrogee, an excess insurer.¹³⁸ In addition, a theory of contractual subrogation permits the inference that after an assignment between an insured and an excess carrier is perfected, the insured's rights and obligations transfer directly to the excess insurer.

Second, the holding is also odd because although many rights, claims and obligations may be assigned, a few cannot. For example, it is a settled principle of tort law that personal negligence actions are not assignable.¹³⁹ Certainly, the majority on the New Hampshire Supreme Court understood this well-known principle. Nevertheless, they ignored or dismissed the point to fashion a profoundly implausible rule: the standard subrogation clause in an underlying insurance contract allows an excess insurer to bring a negligence action to recover extracontractual damages from a primary carrier.¹⁴⁰

For these reasons, *Allstate* is a poorly reasoned decision and adds more confusion to an already complex and highly unintelligible body of law involving bad-faith litigation. More significantly, this decision demonstrates

that *tort claims of this sort are assignable* as choses in action." *Id.* (emphasis added) (citations omitted).

137. *Id.* (emphasis added).

138. See, e.g., *Aetna Casualty & Sur. Co. v. Buckeye Union Casualty Co.*, 105 N.E.2d 568, 572 (Ohio 1952) (recognizing the right of an excess insurer to recover from a primary carrier where the contractual subrogation provision in the liability insurance policy permitted the transfer of rights from the insured to the excess carrier).

139. See *supra* notes 82-83 and accompanying text.

140. *Allstate*, 373 A.2d at 340. However, the court failed to intelligibly address and adequately define the nature and the source of the excess insurer's "personal injury." "Reserve [argued] that under the circumstances presented in [the] case, the assignment [was] ineffective because *no cause of action accrues without injury*." *Id.* (emphasis added). In a strained manner, the court responded:

We cannot accept this argument as we have previously recognized that a *cause of action for negligent failure to settle* is not dependent upon the insured's prior payment or the certainty of his future payment of the judgment against him. . . . [Instead,] *the fundamental basis of the action for negligent failure to settle lies in the absolute control over settlement given to the primary insurer by the insurance contract.*

Id. at 340-41 (emphasis added) (citations omitted).

that state supreme courts apply "pro-insured legal rules" to achieve specific outcomes in a variety of insurance-related actions.¹⁴¹

IV. A CASE STUDY: THE DISPOSITION OF BAD-FAITH, BREACH-OF-CONTRACT, BREACH-OF-IMPLIED-COVENANT-OF-GOOD-FAITH AND EXCESS-LIABILITY ACTIONS IN STATE SUPREME COURTS BETWEEN 1900 AND 1991

State supreme courts are unwittingly discriminating against litigants. In particular, supreme court justices allow immaterial factors to influence the disposition of insurance-related cases in which insureds charge primary carriers with the following violations: breaching insurance contracts; breaching implied covenants of good faith and fair dealing; engaging in a variety of bad-faith activities; and refusing to indemnify or otherwise compensate insureds for judgments which exceed policy limits.

Do extralegal factors, such as race, ethnicity, geographic origin, types of federal circuits, region of country, gender or wealth, singularly influence or determine the outcome of a legal action? Are such variables relevant if a suit involves a civil or criminal matter, or if a court decides an action on procedural or meritorious grounds? Moreover, is concern warranted if it is discovered that after controlling for other relevant variables or issues, one's geographic origin or legal status determines the disposition of state court claims concerned? Finally, is anger justified upon learning that after controlling for all other material factors, state courts are more likely to dismiss female-initiated rather than male-initiated suits on procedural grounds?

The answer to each question is a resounding "yes." In fact, under these scenarios, outrage is fitting because there is little, if any, relevant case law to support or even to suggest one to expect such improbable outcomes. Yet, for reasons unknown, several extralegal factors—those having no purposeful connection with the merits of various types of insurance-related cases—are systematically influencing the disposition of such cases in state supreme courts.

This Part of the Article reports the results of an empirical investigation and analysis of state supreme court cases involving bad-faith, good-faith, ex-

141. Compare Haley & Wolkin, *supra* note 9, at 719 n.18, where the commentators point out that:

Most courts in bond coverage litigation have failed to draw the necessary distinction between commercial and consumer transactions prevalent in other areas of law. Until they do, bonding companies will consistently face extra-contractual claims from well-heeled insureds. . . . There are . . . some encouraging signs that courts have begun to distinguish between types of insureds in *applying pro-insured legal rules*.

Id. (emphasis added).

cess-liability and breach-of-contract actions. The results are nothing short of startling. Variables, which have little to do with the legal issues and theories outlined in the pleadings, as well as factors over which litigants exercise little or no control, significantly shape the likelihood of complaints of insureds, insurers and excess insurers winning on the merits of receiving a favorable outcome on procedural grounds. Even more egregious is the fact that this phenomenon has continued in state supreme courts for nearly 100 years.¹⁴²

This study examined over 500 state supreme court decisions and over 100 state appellate court cases. Table 1 illustrates some selected demographic characteristics of litigants. First, nearly forty percent (38.5%) of *all* claims involved automobile liability insurance. A statistically significant¹⁴³ number of business (26.5%) and property (22.5%) insurance claims appear, however, in appellate cases. More revealing, the overwhelming majority of suits—nearly seventy percent (69.1%) *overall*—were initiated to protect “personal” interests, such as the insureds’ and immediate family-members’ lives, health and personal effects. In fact, among state supreme court suits, the percentage of “personal-insurance” claims is slightly higher (71.5%). Conversely, among appellate cases, a significant number of actions were filed to resolve both “commercial” (27.5%) and “residential” (15.7%) controversies.

142. Efforts were made to locate and select every state supreme court decision reported between 1900-91. In addition, the search was restricted to supreme court cases that involved only the following “theories of recovery:” “bad faith,” “breach of contract,” “breach of an implied covenant of good faith and fair dealing” and “excess liability.” The investigation uncovered 526 supreme court decisions.

For reasons explained below, *see infra* notes 157-59 and accompanying text, an additional sample of 102 state appellate court cases were *randomly* selected, analyzed and included in the study; these latter decisions also involved the previously mentioned “theories” of recovery. Therefore, the database for this empirical study comprises 628 holdings. A copy of the author’s database is available at the office of *Catholic University Law Review*.

143. *See infra* note 142 and accompanying text.

TABLE 1. SOME SELECTED DEMOGRAPHIC CHARACTERISTICS OF COMPLAINANTS WHOSE BAD FAITH, BREACH OF COVENANT OF GOOD FAITH & EXCESS LIABILITY CLAIMS WERE RESOLVED IN STATE APPELLATE & SUPREME COURTS (N=628)

Demographic Characteristics	State Appellate-Court Complainants (N=102)	State Supreme-Court Complainants (N=526)	TOTAL (N=628)
	Percent	Percent	Percent
Type of Insurance:			
Automobile	33.3	39.5	38.5
Business	26.5*	18.8*	20.1
Health	7.8*	13.5*	12.6
Property	22.5*	15.0*	16.2
Other	9.8	13.1	12.6
Interests Protected:			
Commercial	27.5*	18.6**	20.1
Personal	59.9**	71.5**	69.1
Residential	15.7**	9.9**	10.8
Region of Country:			
East	19.6**	9.1**	10.8
Midwest	18.6	22.1	21.5
South	25.5**	35.0**	33.4
Southwest	10.8	10.8	10.8
West	25.5	23.0	23.4
Circuits:			
Eighth	7.8*	13.7*	12.7
Ninth	19.6	18.8	18.9
Tenth	9.8	9.7	9.7
Eleventh	14.7	23.4*	22.0
Others	48.0*	34.4*	36.6
Types of Complainants:			
Insured (Businesses, Corporations, Professionals)	17.6	12.7	13.5
Insured (Individuals)	47.1	54.6	53.3
Third Party	26.5	26.4	26.4
Excess Insurers & Reinsurers	8.8	6.3	6.7

TABLE 1 (Continued)

Demographic Characteristics	State Appellate-Court Complainants (N=102)	State Supreme-Court Complainants (N=526)	TOTAL (N=628)
	Percent	Percent	Percent
Types of Complaints:			
Breach of Contract	10.8	10.6	10.7
Breach of Covenant of Good Faith:			
Excess Judgment	11.8	16.0	15.5
Failure to Defend Suit	42.2***	25.1***	27.9
Refusing to Settle a Claim	9.8	9.7	9.7
Refusing to Settle Within Policy Limits	8.8	10.6	10.4
Refusing to Pay First Party Claim	19.6	24.3	23.6
Refusing to Pay Third Party Claim	42.2	41.8	41.9
	34.3***	17.3***	20.1
Theories of Liability:			
Bad Faith — Common Law	52.9*	62.2*	60.7
Bad Faith — Statute	1.0	4.8	4.1
Breach of Express Contract	31.4	28.1	28.7
Breach of Implied Covenant of Good Faith	25.5	20.5	21.3
Extra-Contractual Liability	43.1***	12.7***	17.7
Grounds for Disposing Actions in State Trial Courts:			
Merit	58.8	58.7	58.8
Procedural	41.2	41.3	41.2
Disposition of Action at Trial Stage From Complainants' Perspectives:			
Favorable Outcome	46.1	48.7	48.4
Unfavorable Outcome	53.9	51.3	51.6
Grounds for Disposing Action in State Supreme Courts:			
Merit	—	62.7	62.7
Procedural	—	37.3	37.3
Disposition of Action in State Supreme Courts From Complainants' Perspectives:			
Favorable Outcome	—	46.2	46.2
Unfavorable Outcome	—	53.8	53.8

Levels of Significance for Chi Square test:

***p < .0001

**p < .01

*p < .04

A regional classification of cases also appears in Table 1. First, a slight majority of all suits originated in the South (33.4%),¹⁴⁴ and an even larger number of suits *were appealed* to supreme courts in the South (35.0%). Also, among state supreme court cases, twenty-two (22.1%) percent were filed in the Midwest.¹⁴⁵ In addition, among state appellate and supreme courts, an identical number of filings were made in the Southwest.¹⁴⁶ Furthermore, among cases originating in the West,¹⁴⁷ nearly equal numbers of filings were resolved in appellate (25.5%) and supreme courts (23.0%). Clearly, cases originating in the East¹⁴⁸ were more likely to be resolved in state appellate courts (19.6%) rather than in state supreme courts (9.1%).

A few other relevant findings also appear in Table 1. First, among both appellate (47.1%) and supreme court (54.6%) decisions, the majority of complainants are *insured individuals*; the second largest category overall is comprised of third parties (26.4%); insured businesses and corporations formed the third largest category at 13.5%; and excess insurers comprise nearly seven percent (6.7%) of all complainants.

Second, when comparing appellate and supreme court complainants, the former are significantly more likely to complain about excess-judgment verdicts (42.2%) and about insurance carriers' refusal to pay third-party claims (34.3%). Conversely, supreme court complainants are slightly more likely to complain about insurers' breach of the covenant of good faith (16.0%) and about carriers' refusal to settle claims within policy limits (24.3%).

Third, appellate and supreme court complainants proffered very different theories of recovery. The latter were significantly more likely to cite a common law theory of bad faith to justify a favorable recovery—62.2% versus 52.9%. By contrast, appellate court petitioners were significantly more likely to cite excess-liability principles to secure a favorable decision—43.1% versus 12.7%.

Finally, Table 1 reveals that among state supreme court cases, the courts decided the majority of suits on the merits (62.7%). Additionally, both overall and from the perspective of supreme court complainants, the majority of plaintiffs received "unfavorable" decisions (53.8%). Furthermore, that fig-

144. The southern states included Alabama, Georgia, Florida, Mississippi, Kentucky, North Carolina, South Carolina, Tennessee and Virginia.

145. The midwestern states included Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, West Virginia and Wisconsin.

146. The southwestern states included Arkansas, Louisiana, Oklahoma and Texas.

147. The western states included Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming.

148. The eastern jurisdictions included Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont.

ure nearly mirrors the "unfavorable" outcome rate (51.3%) appearing in state trial courts between 1900-91.

A. The Effects of Region of the Country and Types of Federal Circuits on the Disposition of Suits in State Supreme Courts

The data in Table 2 depicts the relationship between region of the country and the disposition of various insurance claims in state supreme courts be-

TABLE 2. DISPOSITION OF BREACH-OF-CONTRACT, BAD-FAITH, BREACH-OF-COVENANT-OF-GOOD-FAITH & EXCESS-LIABILITY CLAIMS IN STATE SUPREME COURTS BETWEEN 1900 AND 1991 BY REGION OF COUNTRY (N=526)

Disposition of Claims	Region of Country				
	Eastern Supreme Courts	Midwestern Supreme Courts	Southern Supreme Courts	Southwestern Supreme Courts	Western Supreme Courts
Favorable Outcomes for Complainants	18 (37.5)	53 (45.7)	73 (39.7)	31 (54.4)	68 (56.2)
Unfavorable Outcomes for Complainants	30 (62.5)	63 (54.3)	111 (60.3)	26 (45.6)	53 (43.8)
TOTAL	48 (100.0)	116 (100.0)	184 (100.0)	57 (100.0)	121 (100.0)

Chi Square = 11.029; df = 4
Level of statistical significance: $p < .01$

tween 1900-91. The Chi square statistic (11.029) is statistically significant at a probability level¹⁴⁹ of $p < .01$. Simply stated, this finding indicates that for unknown reasons, region of the country influences whether complainants receive favorable or unfavorable decisions in state supreme courts. Specifically, plaintiffs are more likely to prevail if their actions are decided in supreme courts located in the West (56.2%) and Southwest (54.4%). Conversely, complainants are significantly more likely to lose if their complaints are adjudicated in either eastern (62.5%), midwestern (54.3%) or southern (60.3%) supreme courts.

149. See Willy E. Rice, *Judicial Enforcement of Fair Housing Laws: An Analysis of Some Unexamined Problems that the Fair Housing Amendments Act of 1983 Would Eliminate*, 27 How. L.J. 227, 253-55 & nn.16-162 (1984) (outlining the computation of chi square) [hereinafter Rice, *Fair Housing*].

The percentages appearing in Table 2 arguably indicate that state supreme courts are either "pro-insured" or "pro-insurer." Notwithstanding the results of this survey, other reasons may explain why state supreme courts reach conflicting results. Perhaps the statistical findings reflect nothing more than the differential application of settled principles of contract and tort law among sister states. Or, conceivably, the data may demonstrate that various exceptions to settled principles have developed within various regions of the country. Complainants' probability of success in a particular jurisdiction, therefore, may reflect these factors rather than intentional or unintentional judicial bias.

Some support for this method of reasoning appears in Table 3, which presents the statistically significant relationship between types of federal cir-

TABLE 3. DISPOSITION OF BREACH-OF-CONTRACT, BAD-FAITH, BREACH-OF-COVENANT-OF-GOOD-FAITH & EXCESS-LIABILITY CLAIMS IN STATE SUPREME COURTS BETWEEN 1900 AND 1991 BY TYPES OF FEDERAL CIRCUITS (N=526)

Disposition of Claims	Types of Federal Circuits				
	Supreme Courts Within The Eighth Circuit	Supreme Courts Within The Ninth Circuit	Supreme Courts Within The Tenth Circuit	Supreme Courts Within The Eleventh Circuit	Supreme Courts Within Other Circuits
Favorable Outcomes for Complainants	26 (36.1)	56 (56.6)	26 (51.0)	39 (31.7)	96 (53.0)
Unfavorable Outcomes for Complainants	46 (63.9)	43 (43.4)	25 (49.0)	84 (68.3)	85 (47.0)
TOTAL	72 (100.0)	99 (100.0)	51 (100.0)	123 (100.0)	181 (100.0)

Chi Square = 21.496; df = 4
Level of statistical significance: $p < .0001$

cuits and the disposition of claims. The findings in this table are similar to those reported in Table 2. Among the Eighth and Eleventh Circuits, comprised primarily of midwestern and southern states, complainants are significantly more likely to lose in state supreme courts, the percentages being 63.9% and 68.3%, respectively. Conversely, the majority of states in the Ninth and Tenth Circuits are western states, and within these circuits, complainants are more likely to win.

Again, an investigation of the development of common law tort and contract principles, within and among these distinct geographic areas, failed to reveal any sound support for such regional differences. In fact, a careful analysis of the data illustrated in Table 4 severely undermines the argument

TABLE 4. DISPOSITION OF BAD FAITH, COVENANT OF GOOD FAITH & EXCESS LIABILITY CLAIMS BY REGIONAL STATE SUPREME COURTS (N=478)†

Region of Country	State Supreme Courts	Disposition of Claims From Complainants' View		Number of Cases	Chi Square Value (Degrees of Freedom)
		Favorable	Unfavorable		
		Percent	Percent		
Midwest	Iowa	21.7	78.3	(N=23)	6.632*** (df=2)
	Wisconsin	51.9	48.1	(N=27)	
	Other Courts	51.5	48.5	(N=66)	
South	Alabama	35.6	71.1	(N=90)	9.864*** (df=3)
	Georgia	40.0	60.0	(N=20)	
	Mississippi	57.1	42.9	(N=21)	
	Other Courts	50.9	49.1	(N=53)	
Southwest	Arkansas	33.3	66.7	(N=18)	7.380*** (df=2)
	Oklahoma	50.0	50.0	(N=18)	
	Other Courts	76.2	23.8	(N=21)	
West	Arizona	66.7	33.3	(N=21)	7.688** (df=3)
	California	84.6	15.4	(N=13)	
	Montana	40.9	59.1	(N=22)	
	Other Courts	53.3	47.7	(N=65)	

Levels of statistical significance:

*** $p \leq .01$

** $p \leq .05$

† Forty-eight (48) "Eastern Supreme Court" cases are not included because the cell sizes are too small.

that complainants' likelihood of winning or losing is not significantly influenced by the geographic location of state supreme courts. Clearly, disparate-impact discrimination is at work in supreme courts among sister states.

For example, in the Midwest, complainants are substantially more likely to lose in the Iowa Supreme Court (78.3%), but they are more likely to win in the Supreme Court of Wisconsin (51.9%) and in other midwestern supreme courts (51.5%). Similarly, disparate results also appear among southern supreme courts. For instance, if bad-faith, breach-of-contract, breach-of-covenant-of-good-faith and excess-liability disputes are resolved in

the Supreme Courts of Alabama and Georgia, plaintiffs' risk of losing is substantial—71.1% and 60.0%, respectively. By contrast, aggrieved parties are slightly more likely to win in the Mississippi Supreme Court (57.1%) and in the remainder of southern supreme courts (50.9%).

Finally, unwarranted disparate-impact discrimination also appears among southwestern and western courts. Specifically, within the western region of the country, complainants are more likely to lose in the Supreme Court of Montana (59.1%). In all other western courts, however, aggrieved parties are more likely to win. This is especially true for parties whose complaints originated in California, whose supreme court is more likely to rule in favor of aggrieved parties nearly eighty-five (84.6%) percent of the time.

B. The Effects of Types of Insurance Contracts and Types of Complainants on the Disposition of Suits in State Supreme Courts

At this juncture, a question arises concerning what is especially unique about automobile-insurance policies that would cause courts to rule systematically in favor of or against the owners of such contracts. Expressed another way, do health-insurance policies contain some exceedingly uncommon or legally material attributes that require apparently impartial courts to issue unwarranted, disparate decisions? Of course, the answer is "no." An exhaustive search of relevant common law principles failed to uncover a single credible reason to attach any legal significance to a particular type of insurance contract. This is especially true when courts apply contractual principles to resolve breach-of-contract or breach-of-good-faith-and-fair-dealing controversies.

Yet, a careful examination of the percentages reported in Table 5 reveals that state supreme courts are unwittingly permitting types of insurance contracts to influence their decisions. Table 5 illustrates the disposition of claims among complainants who were successful at trial. Although the majority of all complainants received favorable outcomes, some plaintiffs were more or less successful depending upon the type of their insurance policy. For example, complainants were significantly more likely to prevail if the conflict was over business-insurance policies (78.3%); however, if automobile policies were at issue, complainants were only slightly more likely to receive a favorable decision (51.5%).

TABLE 5. DISPOSITION OF INSURANCE-LITIGATION CLAIMS IN STATE SUPREME COURTS BETWEEN 1900 AND 1991 BY TYPES OF INSURANCE POLICIES—AMONG COMPLAINANTS WHO WERE SUCCESSFUL IN THE TRIAL COURTS (N=256)

Disposition of Claims	Types of Insurance Policies				
	Automobile Insurance	Business Insurance	Health Insurance	Property Insurance	Other Types*
Favorable Outcomes for Complainants	52 (51.5)	36 (78.3)	26 (65.0)	22 (64.7)	22 (62.9)
Unfavorable Outcomes for Complainants	49 (48.5)	10 (21.7)	14 (35.0)	12 (35.3)	13 (37.1)
TOTAL	101 (100.0)	46 (100.0)	40 (100.0)	34 (100.0)	35 (100.0)

Chi Square = 10.134; df = 4

Level of statistical significance: p = .03

* The following types of policies are included: Malpractice; Trip; Annuity; Hail and Crop.

Even if the evidence appearing in Tables 2-5 does not conclusively establish that state supreme courts are engaging in disparate-impact discrimination, perhaps the findings are more convincing in Table 6, which presents the statistically significant relationship between the disposition of actions and the types of complainants. Incidentally, the relationship appears among plaintiffs who accused primary insurers of breaching an implied covenant of good faith and fair dealing.

TABLE 6. DISPOSITION OF INSURANCE-LITIGATION CLAIMS IN STATE SUPREME COURTS BETWEEN 1900 AND 1991 BY TYPES OF COMPLAINANTS — AMONG COMPLAINANTS WHO COMMENCED THEIR CAUSES OF ACTIONS UNDER A THEORY OF AN IMPLIED COVENANT OF GOOD FAITH (N=108)

Disposition of Claims	Types of Complainants			
	Insureds (Non-Individuals)	Insureds (Individuals)	Third Party*	Insurers (Reinsurers & Excess Insurers)
Favorable Outcomes for Complainants	5 (35.7)	42 (73.7)	14 (50.0)	3 (33.3)
Unfavorable Outcomes for Complainants	9 (64.3)	15 (26.3)	14 (50.0)	6 (66.7)
TOTAL	14 (100.0)	57 (100.0)	28 (100.0)	9 (100.0)

Chi Square = 11.627; df = 3

Level of statistical significance: $p < .001$

* The following are included in this category: Agents; Administrators; Assignees; Beneficiaries; Creditors; Judgment Creditors; Receivers; Trustees; Partners; & Uninsureds

Surprisingly, and without any apparent legal basis, state supreme courts are likely to rule in favor of insureds (73.7% of the time) if the insureds are individual policyholders. In contrast, if the complaining insureds are not individuals, such as associations, partnerships, municipalities, corporations, or small enterprises, the insureds are significantly more likely to lose (64.3%). Also, complainants are significantly more likely to lose if they are excess insurers or reinsurers (66.7%).

Why are state supreme courts discriminating among types of insureds? Many legal scholars, jurists and practitioners agree that an *individual consumer* "who obtains an insurance policy is entitled to some degree of judicial protection, [but] an *insurer who obtains a reinsurance contract* is not entitled to that same degree of judicial protection since there is generally no disparity between the bargaining power of the reinsured and the reinsurer."¹⁵⁰ Such

150. Crowley v. Lafayette Life Ins. Co., 683 P.2d 854, 857 (Idaho 1984) (emphasis added); see Morgan v. Cincinnati Ins. Co., 307 N.W.2d 53, 54 (Mich. 1981) ("Recognizing the disparity in the bargaining positions of the companies which write insurance and the consumers who buy the policies, both the statutory law and judicial decisions have aimed at making certain that the *interests of every insured* are protected") (emphasis added).

sentiment partially explains why reinsurers or excess insurers are more likely to be unsuccessful against primary carriers in state supreme courts.

This disparity-in-bargaining-power analysis does not adequately explain or justify the incidence of disparate-impact discrimination appearing among various types of insureds. This view is proffered because conceivably every insured's bargaining position is somewhat inferior to that of primary insurers. By all objective measures, insurance companies are extremely powerful bargainers.¹⁵¹

More important, for years state supreme courts have employed the "traditional theory" of strict contractual construction,¹⁵² the "doctrine of ambiguity,"¹⁵³ and the "theory of reasonable expectation"¹⁵⁴ to resolve disputes

151. For example, in *Santilli v. State Farm Life Ins. Co.*, 562 P.2d 965 (Or. 1977) (citation omitted), the Supreme Court of Oregon noted that:

the huge financial reserves of large insurance companies give them an advantageous bargaining position when dealing with injured policyholders who are suddenly faced with the ruinous bills which they purchased insurance to avoid. . . . [S]ome insurance companies have taken advantage of this superior bargaining position and have sought to force their insureds [apparently without distinguishing among types] to settle for significantly less than they were entitled to through deliberate patterns of harassment and delay.

Id. at 968-69 n.5.

152. The "traditional" approach requires a court to examine the "four corners" of an insurance contract and interpret the language according to common law contract principles. *See, e.g.*, *Duke v. Mutual Life Ins. Co.*, 210 S.E.2d 187, 189 (N.C. 1974) ("where the language of an insurance policy is plain, unambiguous, and susceptible of only one reasonable construction, the courts will enforce that contract according to its terms." (emphasis added) (quoting *Walsh v. Insurance Co.*, 144 S.E.2d 817, 820 (1965)); *Brown v. Equitable Life Ins. Co.*, 211 N.W.2d 431, 435 (Wis. 1973) (stressing that "the theory of strict contractual construction of insurance contracts followed by a majority of jurisdictions is consistent with the philosophy of this court. 'Contracts of insurance rest upon and are controlled by the same principles of law that are applicable to other contracts.'" (emphasis added) (quoting *McPhee v. American Motorist's Ins. Co.*, 205 N.W.2d 152, 155 (Wis. 1973))).

153. Some courts view insurance policies as contracts of adhesion. These tribunals construe ambiguities in favor of insureds. The insured's legal status or economic or personal characteristics are therefore unimportant. *Cf. Gray v. Zurich Ins. Co.*, 419 P.2d 168, 171 (Cal. 1966) ("[A] contract entered into between two parties of unequal bargaining strength . . . written by the more powerful bargainer to meet its own needs, and offered to the weaker party on a 'take it or leave it basis' carries some consequences that extend beyond orthodox [contractual] implications"); *Prudential Ins. Co. v. Lamme*, 425 P.2d 346, 347 (Nev. 1967) (explaining that insurance contracts are "complex instrument[s], unilaterally prepared, and seldom understood by the assured").

154. *See FISCHER & SWISHER, supra* note 116, at 2, advancing the proposition that: The basis of [the reasonable expectation] theory is two fold: (1) that an insurer should be denied any unconscionable advantage in an insurance transaction; and (2) that the 'reasonable expectations' of the insured should be honored, even when these expectations vary from express provisions in the insurance contract, and even though painstaking study of the insurance policy provisions would have negated these expectations.

between insureds and primary insurers. These tribunals rarely made distinctions or weighed obvious differences among various insureds to reach sound legal decisions. In fact, for nearly 100 years state supreme courts consistently refused to make such differentiation¹⁵⁵ and did so only when statutory law compelled it.¹⁵⁶

Nevertheless, these research findings are statistically significant and, arguably, quite compelling. Apparently, state supreme court justices unintentionally allow the types of insureds (complainants) to influence the disposition of bad-faith, extra-contractual liability, breach-of-good-faith, and breach-of-contract actions.

C. *A Multivariate Probit Two-Stage Analysis of the Disposition of Insurance-Related Cases in State Supreme Courts, 1900-1991*

Are state supreme courts truly biased against insureds who are not individuals and against policyholders who purchase health insurance rather than business insurance? Or, do the supreme courts of Arizona, California, Mississippi and Wisconsin favor aggrieved parties who complain about bad-faith rather than breach-of-contract violations? Or, are the Supreme Courts of Alabama, Arkansas, Georgia and Iowa "pro-insurer" rather than "pro-consumer" courts?

Id.; see also *Storms v. United States Fidelity & Guar. Co.*, 388 A.2d 578, 580 (N.H. 1978) ("If a policy is so constructed that a reasonable man in the position of the insured would not attempt to read it, the insured's reasonable expectations will not be delimited by the policy language, regardless of the clarity of particular phrase among the Augean stable of print").

155. See *Haley & Wolkin*, *supra* note 9, at 719 n.18. ("There are . . . some encouraging signs that courts have begun to distinguish between types of insureds in applying . . . legal rules"). See generally, Barry R. Ostrager & David W. Ichel, *The Role of Bargaining Power Evidence in the Construction of the Business Insurance Policy: An Update*, 18 FORUM 577 (1983). The reason that courts have not been, and need not be, concerned about distinguishing among the types of insureds should be fairly obvious. By all objective criteria, it is, or should be legally immaterial whether an insured is a private individual, a general or limited partner, an association, a professional or a "mom-and-pop" business. Moreover, strict rules of contract do not require courts to consider the attributes of parties to an insurance contract. *But see* *Collister v. Nationwide Life Ins. Co.*, 388 A.2d 1346, 1352-53 (Pa. 1978), *cert. denied*, 439 U.S. 1089 (1979) ("The traditional contractual approach fails to consider the true nature of the relationship between the insurer and its insureds. Only through the recognition that insurance contracts are not freely negotiated agreements . . . and that the insured cannot 'bargain' . . . does our analysis approach the realities of an insurance transaction").

156. See, e.g., *State Farm Mut. Auto. Ins. Co. v. Jackson*, 462 So. 2d 346, 349 (Ala. 1984) (repeating its ruling in *State Farm Auto. Ins. Co. v. Reaves*, 292 So. 2d 95, 98 (Ala. 1974) ("the legislature intended to draw a distinction between the two types of insureds, and did indeed intend to require uninsured motorist coverage for the broader class 'persons insured thereunder'"); *Aetna Casualty & Sur. Co. v. Barker*, 451 So. 2d 731, 732 (Miss. 1984) ("[t]he statutes and authorities are clear that there are two separate and distinct types of insureds under uninsured motorist coverage and the terms of these statutes are incorporated in all motor vehicle policies where uninsured motorist coverage is provided").

Apparently, these supreme tribunals are biased and are intentionally or unintentionally permitting extralegal factors to influence the outcome of excess-liability, bad-faith, breach-of-contract and breach-of-good-faith suits. An examination of Tables 2-6 support such an inference.

Possibly, a less obvious statistical aberration might be causing the apparent judicial bias or unwarranted, disparate-impact discrimination. Alternatively, each reported "significant" extralegal factor may be masking the influence of an even more obscure, significant legal factor which has not been measured and assessed in this study. Stated differently, some other underlying, material legal factor which is highly "correlated" with these "impermissible" variables may be producing, arguably, unusual statistical findings.

For example, Table 7 presents the relationship between types of dispositions and various theories of recovery. Not surprisingly, the relationship is

TABLE 7. DISPOSITION OF INSURANCE - LITIGATION CLAIMS IN STATE SUPREME COURTS BETWEEN 1900 AND 1991 BY VARIOUS THEORIES OF LIABILITY (N=526)

Disposition of Claims	Theories of Liability				
	Contract: Breach of Express Terms & Conditions	Contract: Breach of an Implied Covenant of Good Faith & Fair Dealing	Extra-Contractual: Breach of an Implied Covenant of Good Faith & Fair Dealing	Tort: Independent Tort of Bad Faith	Other Legal Theories*
Favorable Outcomes for Complainants	61 (41.2)	54 (62.1)	26 (44.8)	91 (44.0)	11 (42.3)
Unfavorable Outcomes for Complainants	87 (58.8)	33 (37.9)	32 (55.2)	116 (56.0)	15 (57.7)
TOTAL	148 (100.0)	87 (100.0)	58 (100.0)	207 (100.0)	26 (100.0)

Chi Square = 10.913; df = 4

Level of statistical significance: $p < .01$

* These are: Intentional Torts; Negligence; Fraud; Equity; Civil RICO; Violations of Unfair Claims Practice Statutes; and Violations of Business Practices Acts.

statistically significant. The results show that complainants are significantly more likely to win when primary insurers are accused of breaching an implied covenant of good faith and fair dealing (62.1%). However, complain-

ants are more likely to lose when breach-of-express-contract (58.8%), tort-of-bad-faith (55.2%), excess-judgment (56.0%) and other legal actions (57.7%) are filed.

What are the "true" predictors of judicial outcomes in state supreme courts? Are the extralegal variables reported above more important? Or, are types of legal theories more relevant? Without further analysis, a conclusive answer cannot be presented.

The results illustrated in Table 8 raise similar questions. Here, several statistically significant relationships appear between selected demographic characteristics and the grounds for disposing state supreme court cases. First, complainants are significantly more likely to be unsuccessful when cases are decided on procedural grounds (61.5%). It is also evident, however, that failure-to-settle suits, as well as suits originating in Wisconsin and in Alabama, are more likely to be resolved procedurally; the respective percentages are 52.8%, 63.0%, and 43.3%. Conversely, excess-judgment and failure-to-defend cases, along with cases originating in Iowa, Georgia and other midwestern and southern supreme courts, are considerably more likely to be decided on the merits.

As noted, many of these same demographic characteristics are closely associated with judicial outcomes. These characteristics also influence whether state supreme court actions are disposed of procedurally or on the merits. The task, therefore, of deciphering the true predictors of judicial outcomes is complicated by the unexpected revelation that complainants' likelihood of winning or losing a case is significantly related to whether courts decide cases on meritorious or procedural grounds. At this juncture, however, it is unclear whether extralegal or legal factors are more relevant.

Finally, a phenomenon called "self-selectivity bias"¹⁵⁷ may be causing disparate-impact discrimination. Such bias often arises in samples because of the differences between those who decide to commence, for example, bad-faith or breach-of-contract actions, and those who decide not to initiate such actions. Alternatively, an otherwise fairly random sample of breach-of-good-faith cases may be comprised primarily of aggrieved individuals who decided to file suits in state courts and decided to appeal adverse trial-court

157. See, e.g., G.S. MADDALA, LIMITED-DEPENDENT AND QUALITATIVE VARIABLES IN ECONOMETRICS, 257-89 (1983). For examples of, and tests for, self-selectivity bias from a legal point of view, see Willy E. Rice, *Judicial and Administrative Enforcement of Individual Rights Under the National Labor Relations Act and Under the Labor-Management Relations Act Between 1935 and 1990 — An Historical and Empirical Analysis of Unsettled Intercircuit and Intracircuit Conflicts*, 40 DEPAUL L. REV. 653, 730-34 (1991) [hereinafter Rice, *Enforcement Under the Labor Acts*], and Willy E. Rice, *Judicial and Administrative Enforcement of Title VI, Title IX, and Section 504: A Pre- and Post-Grove-City Analysis*, 5 REV. LITIG. 219, 279-82 (1986) [hereinafter Rice, *Grove-City Analysis*].

TABLE 8. THE RELATIONSHIP BETWEEN SELECTED DEMOGRAPHIC CHARACTERISTICS AND THE LIKELIHOOD OF STATE SUPREME COURTS' BAD FAITH, COVENANT OF GOOD FAITH & EXCESS LIABILITY ACTIONS BEING DECIDED ON THE MERITS OR ON PROCEDURAL GROUNDS

Demographic Characteristics	Sub-Categories	Ground for Disposing Case		Number of Cases	Chi Square Value (Degree of Freedom)
		Merits	Procedural		
Types of Complaints	Excess Judgment	Percent 69.2	Percent 30.8	(N = 132)	13.062**** (df = 4)
	Failure to Defend	57.1	42.9	(N = 51)	
	Failure to Settle, Per Se	47.2	52.8	(N = 56)	
	Failure to Settle (Policy Limits)	73.4	26.6	(N = 128)	
	Other Complaints	60.8	39.2	(N = 161)	
Midwestern Supreme Courts	Iowa	56.5	43.5	(N = 23)	8.585**** (df = 2)
	Wisconsin	37.0	63.0	(N = 27)	
	Others	69.7	30.3	(N = 66)	
Southern Supreme Courts	Alabama	56.7	43.3	(N = 90)	8.042** (df = 3)
	Georgia	85.0	15.0	(N = 20)	
	Mississippi	66.7	33.3	(N = 21)	
	Others	73.6	26.4	(N = 53)	
Disposition of Claims From Complainants' Perspective	Favorable	50.6	38.5	—	6.795**** (df = 1)
	Unfavorable	49.4	61.5	—	
		(N = 330)		(N = 195)	

Levels of statistical significance: **** p < .001
 *** p < .01
 * p < .05

TABLE 9. THE EFFECTS OF SELECTED VARIABLES ON COMPLAINANTS' DECISION TO SEEK REDRESS IN STATE SUPREME COURTS AND ON THE DISPOSITION OF BREACH-OF-CONTRACT, BAD-FAITH, BREACH-OF-AN-IMPLIED-COVENANT-OF-GOOD-FAITH & EXCESS-LIABILITY INSURANCE CLAIMS IN THOSE STATE SUPREME COURTS BETWEEN 1900 AND 1991

Selected Predictor Variables Demographic Attributes)	Decision to Appeal Breach-of-Contract, Bad-Faith, Breach-of-Good-Faith & Excess-Liability Claims to a State Supreme Court (N=628)		Disposition of Breach-of-Contract, Breach-of-Good-Faith, Bad-Faith & Excess-Liability Claims in State Supreme Courts (N=526)		Disposition of the Same Four Types of Claims in State Supreme Courts — Among Complainants Who Were Successful at Trial & Whose Claims Concerned "Personal" Insurance (N=324)	
	Probit Coefficients (Standard Errors)	Absolute Values of t - Statistics	Probit Two-Stage Coefficients (Standard Error)	Absolute Values of t - Statistics	Probit Two-Stage Coefficients (Standard Errors)	Absolute Values of t - Statistics
Types of Insurance:						
Automobile	.2986 (.2702)	1.105	-.3082 (.1319)	2.337	-.0181 (.1901)	.095
Business	-.0249 (.2734)	.091	-.1383 (.2651)	.521	.0041 (.3167)	.013
Health	.1018 (.3488)	.291	-.2806 (.1940)	1.446	-.3951 (.3340)	1.183
Property	-.4649 (.2926)	1.588	-.6368 (.1721)	3.700**	-.4062 (.2737)	1.483
Circuits:						
Ninth	-.2543 (.2074)	1.226	.1339 (.1420)	.943	-.0578 (.2115)	.273
Eleventh	-.1191 (.2302)	.517	-.3777 (.1431)	2.638	-.2647 (.2051)	1.290
Types of Complainants: Insured (Individuals)						
Third Party	.2627 (.2195)	1.196	.4071 (.1247)	3.263	.2032 (.1746)	1.164
Types of Complainants: Breach of Express Contract	-.2007 (.2552)	.786	-.2395 (.2721)	.880	-.2275 (.3631)	.626
Types of Complainants: Breach of Good-Faith Covenant	-.1252 (.2911)	.430	-1.6390 (.2922)	5.608****	-1.5292 (.2990)	5.113****
Excess Judgment	.5990 (.3177)	1.885	.3782 (.5166)	.732	.2545 (.6618)	.354
	-.5799 (.2002)	2.896	-.0918 (.4623)	.195	-1.330 (.3173)	4.193****

TABLE 9 (continued)

Selected Predictor Variables Demographic Attributes)	Decision to Appeal Breach-of-Contract, Bad-Faith, Breach-of-Good-Faith & Excess-Liability Claims to a State Supreme Court (N = 628)		Disposition of Breach-of-Contract, Breach-of-Good-Faith, Bad-Faith & Excess-Liability Claims in State Supreme Courts (N = 526)		Disposition of the Same Four Types of Claims in State Supreme Courts — Among Complainants Who Were Successful at Trial & Whose Claims Concerned "Personal" Insurance (N = 324)	
	Probit Coefficients (Standard Errors)	Absolute Values of t - Statistics	Probit Two-Stage Coefficients (Standard Error)	Absolute Values of t - Statistics	Probit Two-Stage Coefficients (Standard Errors)	Absolute Values of t - Statistics
Theory of Liability: An Implied Covenant of Good Faith and Fair Dealing	-.5494 (.2594)	2.118	-.0092 (.6052)	.015	-.8777 (.6337)	1.385
Grounds for Disposing Claims: State Trial Courts	-.2617 (.2665)	.982	.4748 (.1087)	4.367***	-.1442 (.1773)	.813
State Court of Appeals	.5618 (.2702)	2.079	.0349 (.0341)	1.025	.0223 (.0475)	.470
LAMBDA Term ("Self-Selectivity Bias" Test)	—	—	.2354 (.5099)	.461 (NS)	.4143 (.6932)	.597 (NS)
CONSTANT	.4280 (.2819)	1.518	-.7502 (.3215)	2.333		

Levels of Statistical Significance: **** p < .0001

*** p < .001

(NS) = Not Statistically Significant

decisions to a state appellate or supreme court, if they were the losing parties.

Self-selection bias might also appear in another form.¹⁵⁸ Complainants who were successful at trial level would have no reason to appeal to a state supreme court, and therefore would not appear in a particular sample of cases. They would have excluded themselves from the original pool of disgruntled complainants. Under either scenario an otherwise fairly random sample would be unscientific, and it would be highly improper to conclude that judicial bias is producing the disparate-impact discrimination. Thus, a test is required to determine whether selectivity bias is evident in the sample.

Table 9 displays the results of a multivariate probit two-stage analysis.¹⁵⁹ This statistical technique answers two important questions. First, does a statistically significant amount of self-selectivity bias appear in a sample? Second, are the simultaneous and multiple effects of extralegal and legal factors on the disposition of insurance-related, state supreme court actions statistically meaningful, if selectivity bias is absent?¹⁶⁰

The multivariate probit coefficients appearing in the "Decision-to-Appeal" column provide the answer to the question whether any of the selected "predictors," such as types of insurance or complainants, explain who is more likely to appeal an insurance-related case to a state supreme court. The answer is none of the probit coefficients are statistically relevant. Put differently, this probit procedure—which controls for the independent as well as *the multiple, simultaneous effects of all factors*—failed to uncover any

158. See Rice, *Enforcement Under the Labor Acts*, *supra* note 157, at 733.

Additionally, the difference between litigants' financial resources is often another source of selectivity bias because a positive relationship exists [sic] between the level of one's financial resources and one's ability to purchase good legal representation. Therefore, a finding that [complainants are more or less likely to win in state supreme courts] could be a reflection of differential access to adequate resources rather than a reflection of judicial bias.

Id.

159. This procedure has been fairly discussed elsewhere. See Rice, *Enforcement Under the Labor Acts*, *supra* note 157, at 733 & n.491; Rice, *Grove-City Analysis*, *supra* note 157, at 286-87 & nn. 406-10.

160. Before answering these questions, some preliminary comments are warranted. First, several "predictor" variables appear in the extreme left column of Table 9. These statistically significant "predictors," have been seen before and are illustrated separately in Tables 3, 5, 6 and 7. The importance of these factors is assessed here because of their singular and significant influence upon the disposition of excess-liability, breach-of-contract, bad-faith, and other types of insurance-related cases.

Second, all 628 complainants within the sample appealed their actions to a state appellate court. Of this group, 526 aggrieved litigants decided to obtain additional review in a state supreme court, while 102 complainants decided not to pursue further review in a supreme court.

meaningful differences between those who decided to seek review in a state supreme court and those who did not.

The information appearing in the two "Disposition-of-Bad-Faith" columns in the center of Table 9 answer the two original questions. First, the statistically insignificant *lambda* term (.2354) reveals the absence of self-selectivity bias in the sample of 526 supreme court cases. This coefficient also means that certain distinctive attributes of aggrieveds seeking supreme court review are less likely to influence judicial decisions.

Second, three statistically significant probit coefficients appear under the heading of "Disposition of Bad Faith." The negative 1.6390 probit term indicates that complainants who commence a breach-of-contract action are significantly more likely to lose in state supreme courts. In contrast, the positive .4748 coefficient suggests that complainants are more likely to win if state trial courts decide those cases on the merits.

The latter finding is not dramatic. In fact, it illustrates that trial court determinations will remain intact, unless the court abuses its discretion.¹⁶¹ That aggrieveds are *more likely to lose a breach-of-contract* action in state supreme courts is curious, however, because the finding deviates considerably both from the pro-consumer dicta in supreme court opinions and from scholarly analyses in insurance-related law review articles.¹⁶²

161. See, e.g., *Barnett v. Arkansas Transp. Co.*, 798 S.W.2d 79, 82 (Ark. 1990) (holding that an abuse of discretion is the appropriate standard of review); *Kiner v. Reliance Ins. Co.*, 463 N.W.2d 9, 13 (Iowa 1990) (same); *Industrial Indem. Co. v. Kallevig*, 792 P.2d 520, 531 (Wash. 1990) (same).

162. See, e.g., *Lightner v. Centennial Life Ins. Co.*, 744 P.2d 840, 845 (Kan. 1987) ("An insurance contract is generally liberally construed against the insurer. . . . The basis for construing an insurance policy against the insurer in close cases is simply the rule of contracts that the drafter must suffer the consequences of not making the terms clear") (emphasis added); *Collister v. Nationwide Life Ins. Co.*, 388 A.2d 1346, 1353 (Pa. 1978), cert. denied, 439 U.S. 1089 (1979) ("Courts should be concerned with assuring that the insurance purchasing public's reasonable expectations are fulfilled. Thus, regardless of the ambiguity . . . inherent in a given set of insurance documents . . . the public has a right to expect that they will receive something of comparable value in return for the premium paid") (emphasis added); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1174-80 (1983) (arguing that the terms in form contracts, like insurance policies, should be presumptively invalid, because consumers often do not read form insurance contracts and such contracts do not permit consumers to give or withhold meaningful consent to the terms of contracts of adhesion); see also Young, *supra* note 17, at 71.

[C]ourts . . . have historically viewed insurance policies as but another form of contract, and consequently have, at least ostensibly, construed them according to rules of construction applicable to contracts generally. At the same time, the courts have increasingly recognized that an inflexible application of these rules would result in an 'unjust' decision. In order to protect the weaker party, the policyholder, while purportedly following recognized principles of contract construction, courts have . . . twisted existing doctrines.

Id. (emphasis added).

The third statistically meaningful finding, however, is both surprising and egregious. The negative .6368 probit coefficient reveals that state supreme courts permit the *type of insurance contract* to influence the disposition of bad-faith, breach-of-good-faith, breach-of-contract and excess-judgment actions. Specifically, purchasers of property-insurance—such as homeowner's, flood and earthquake coverage—are substantially more likely to lose than consumers who purchase other types of policies. Again, this finding is exceptional, because it occurs even after the effects of other legal and extralegal factors are held constant. Moreover, the finding is unwarranted, because common law contractual principles neither mandate nor suggest such an improbable result.

Finally, the data presented in the last two columns of Table 9 suggest that state supreme courts practice unwarranted, disparate-impact discrimination. There, two statistically significant factors are evident.¹⁶³ The negative 1.5292 coefficient reconfirms the earlier finding that complainants who commence breach-of-contract actions are more likely to lose. Likewise, plaintiffs who initiate excess-judgment actions are more likely to lose. The statistically meaningful probit coefficient is negative 1.330.

The latter findings are particularly vexatious for two reasons. First, as the heading over the last two columns indicates, these results appear *among complainants who prevailed in state trial courts*. To comport with the previously discussed findings, this subgroup of aggrieveds should have been successful. As noted, state trial court deliberations are not reversed, absent an abuse of discretion.¹⁶⁴ More important, these unique statistical outcomes only appear among complainants whose claims involved "personal" insurance.¹⁶⁵ In addition, neither common law contractual principles, the doctrine of ambiguity, the doctrine of reasonable expectation, nor the common law doctrine of bad faith supports or causes one to expect such improbable outcomes in state supreme courts.¹⁶⁶

*D. Recommendations to Cure the Disparate Treatment of Aggrieveds
Whose Insurance-Related Claims are Resolved in
State Supreme Courts*

This Article demonstrates that state supreme courts are inhospitable forums for resolving insurance-related bad-faith, breach-of-contract, breach-of-covenant-of-good-faith and excess-liability claims. Briefly stated, too

163. Notably, the test for self-selectivity bias is insignificant.

164. See *supra* note 161 and accompanying text.

165. See Table 1 and the accompanying discussion.

166. See generally *supra* notes 53-60, 152-54 and accompanying text.

many state supreme courts either fail or refuse to clearly identify the requisite elements that a complainant must prove to prevail, for example, in a bad-faith cause of action. Often these supreme tribunals simply conclude that “bad faith” was or was not present. Notably, it is rare for a state supreme court to outline a sound methodology that would help lower courts resolve bad-faith as well as breach-of-good-faith and excess-liability actions.

Additionally, in many states the standard of care to which primary insurance carriers must conform is not clear. For example, some supreme courts apply and condone the use of both a negligence and an intent standard to resolve bad-faith conflicts.¹⁶⁷ Other courts “adopt” a “fairly debatable” or “arguably debatable” standard to resolve various controversies.¹⁶⁸ Apparently, state supreme courts “adopt” or manufacture a myriad of ambiguous and conflicting standards without addressing the manner in which lower state courts should interpret and apply such standards. In addition, state supreme courts apply various legal principles inconsistently, making it difficult to predict whether a case will be decided on the merits or on procedural grounds, or to predict whether a complainant will win or lose.

The survey’s most significant finding centers on the way state supreme courts permit immaterial evidence to influence the disposition of insurance-related actions. Purchasers of insurance products should not receive favorable outcomes in state supreme courts simply because they accused primary carriers of violating some principle of law. Moreover, supreme court judges should not—either intentionally or unintentionally—permit irrelevant factors to shape their decisions.

What should be done to remedy the problems uncovered here? First, consumers who complain about the types of insurance-related violations discussed in this Article should be prevented from obtaining judicial review of bad-faith, excess-liability, breach-of-contract and breach-of-good-faith actions in state supreme courts. Second, an outright bar upon these types of suits from all state courts would be an even more appropriate response; an administrative rather than a judicial proceeding is a better forum for resolving insurance disputes because these disputes often require “expert” attention.¹⁶⁹ Thus, submitting an insurance-law controversy to a highly trained and experienced state administrative law judge (ALJ) better serves the interest of all parties.

167. See *supra* notes 48, 51-52.

168. See *supra* notes 46, 47.

169. See Rice, *Enforcement Under the Labor Acts*, *supra* note 157, at 734-37; Rice, *Fair Housing*, *supra* note 149, at 271-74; Rice, *Grove-City Analysis*, *supra* note 157, at 281-82.

A majority of states¹⁷⁰ have adopted either all, or substantial portions of the National Association of Insurance Commissioners' (NAIC) model legislation, which proscribes egregious claims-settlement acts as well as unfair and deceptive practices.¹⁷¹ In particular, section 4(9) of the Model Act prohibits insurance carriers from engaging in a variety of acts that violate policyholders' reasonable expectations.¹⁷² More important, the Model Act's

170. The following state statutes are substantially identical to Section 4(9) of the Model Act: ALA. CODE § 27-12-24 (1986); ALASKA STAT. § 21.36.125 (1991); ARIZ. REV. STAT. ANN. § 20-461 (1990); ARK. CODE ANN. § 23-66-206 (Michie 1987); CAL. INS. CODE § 790.03(h) (Deering 1976); COLO. REV. STAT. § 10-3-1104(h) (1987); CONN. GEN. STAT. ANN. § 38-61(6) (West 1987); DEL. CODE ANN. tit. 18, § 2304(16) (1974); FLA. STAT. ANN. § 626.9541(9) (West 1984 & Supp. 1992); HAWAII REV. STAT. § 431:13-103(a)(10) (1985); IDAHO CODE § 41-1329 (1985); IND. CODE ANN. § 27-4-1.5 (Burns 1992); IOWA CODE ANN. § 507B.4(9) (West 1988); KAN. STAT. ANN. § 40-2404(9); MASS. GEN. LAWS ANN. ch. 176D, § 3 (West 1987); MICH. COMP. LAWS ANN. § 500.2026 (West 1983); MINN. STAT. ANN. § 72A.20 (West 1986); MO. ANN. STAT. § 375.936(10) (Vernon 1991); MONT. CODE ANN. § 33-18-201 (1991); NEB. REV. STAT. § 44-1525(9) (1988); NEV. REV. STAT. § 686A.310 (1957); N.H. REV. STAT. ANN. § 417:4 (1983); N.J. REV. STAT. § 17:29B-4(9) (1985); N.M. STAT. ANN. § 59A-16-20 (Michie 1988); N.Y. INS. LAW § 2601 (McKinney 1985); N.C. GEN. STAT. § 58-54.4(11) (1991); N.D. CENT. CODE § 26.1-04-03(9) (1989); OKLA. STAT. tit. 36, § 1222 (1990); OR. REV. STAT. § 746.230 (1991); PA. STAT. ANN. tit. 40, § 1171.5(a)(10) (1992); TENN. CODE ANN. § 56-8-104(8) (1989); TEXAS REV. CIV. STAT. ANN. art. 21.21-2 (West 1981); UTAH CODE ANN. § 31A-26-303 (1991); VT. STAT. ANN. tit. 8, § 4729(9) (1992); VA. CODE ANN § 38.2-510 (Michie 1990); W. VA. CODE § 33-11-4(9) (1992); WYO. INS. CODE § 26-13-124 (1991).

The following statutes are somewhat similar to the Model Act. They prohibit unfair and deceptive acts and practices; however, claims-settlement practices are not clearly mandated: ILL. REV. STAT. ch. 73, § 766.6 (1965); KY. REV. STAT. ANN. § 304.12-230 (Baldwin 1987); LA. REV. STAT. ANN. § 22:658 (West 1978); ME. REV. STAT. ANN. tit. 24A, § 2164-D (West 1964); MD. ANN. CODE art. 48A, § 213 (1991); MISS. CODE ANN. § 83-5-33 (1972); OHIO REV. CODE ANN. § 3901.19 (Baldwin 1991); R.I. GEN. LAWS § 9-1-33 (1989); S.C. CODE ANN. § 38-59-20 (Law. Co-op. 1989); S.D. CODIFIED LAWS ANN. § 58-33-66 (1990); WASH. REV. CODE ANN. § 48.30.010 (West 1984); WIS. STAT. ANN. § 628.46 (West Supp. 1991).

As of this writing, the District of Columbia, Georgia and Rhode Island have not enacted statutes which are either identical or substantially similar to the Model Act.

171. AN ACT RELATING TO UNFAIR METHODS OF COMPETITION AND UNFAIR AND DECEPTIVE ACTS AND PRACTICES IN THE BUSINESS OF INSURANCE § 4 (9) (National Ass'n of Ins. Comm'rs 1972) [hereinafter MODEL ACT]. The full text of the 1985 version appears in *Bad Faith and Punitive Damages: Annotations to First-Party Insurance Cases, Statutes, and Regulations*, 1986 A.B.A. COMM. PROP. INS. L. & SEC. TORT & INS. PRAC. 337-48 [hereinafter A.B.A. *Bad-Faith Annotations*].

172. The California legislature has enacted California Insurance Code § 790.03(h), which is substantially similar to § 4(9) of the Model Act. See, e.g., *Royal Globe Ins. Co. v. Superior Court*, 592 P.2d 329, 331 n.1 (Cal. 1979), *overruled on other grounds*, *Moradi-Shalal v. Fireman's Fund Ins. Co.*, 758 P.2d 58 (Cal. 1988). *Royal Globe* sets forth the California Insurance Code provision as follows:

Section 790.03 provides in part: 'The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance.

.....

enforcement provisions¹⁷³ require aggrieved consumers to seek relief in an administrative rather than in a judicial forum.

To date, a careful reading of settlement-practice provisions among the states reveals that various administrative enforcement mechanisms and sanctions are highly inadequate. In most states, the insurance commissioner has sole discretion to investigate alleged violations of claims-settlement provi-

'(h) Knowingly committing or performing with such frequency as to indicate a general business practice any of the following unfair claims settlement practices:

'(1) Misrepresenting to claimants pertinent facts or insurance policy provisions relating to any coverages at issue.

'(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

'(3) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

'(4) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured.

'(5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear.

'(6) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when such insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

'(7) Attempting to settle a claim by an insured for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.

'(8) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured, his representative, agent, or broker.

'(9) Failing, after payment of a claim, to inform insureds or beneficiaries, upon request by them, of the coverage under which payment has been made.

'(10) Making known to insureds or claimants a practice of the insurer 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.

'(11) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of 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.

'(12) Failing to settle claims promptly, where liability has become apparent, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

'(13) Failing to provide promptly a reasonable explanation of the basis relied on in the insurance policy, in relation to the facts or applicable law, for the denial of a claim or for the offer of a compromise settlement.

'(14) Directly advising a claimant not to obtain the services of an attorney.

'(15) Misleading a claimant as to the applicable statute of limitations.'

Id.

173. See generally, MODEL ACT, *supra* note 171, at §§ 7(a)-(e), 8(a)-(c).

sions.¹⁷⁴ Insurance commissioners' enforcement powers, though, are highly restricted because most states only allow commissioners to issue cease-and-desist orders after these officers determine that insurers have violated claims-settlement provisions.¹⁷⁵ Additionally, insurance commissioners may seek injunctive relief in state courts and assess modest civil penalties against offending primary carriers.¹⁷⁶

Finally, although most claims-settlement provisions correctly prevent aggrieved consumers from initiating private causes of actions against offending primary insurers, states' administrative procedures do not adequately compensate aggrieved individuals.¹⁷⁷ Legislatures should revise current laws so that aggrieved consumers have the definitive right to recover both compensatory and punitive awards, if an ALJ's findings warrant such compensation.

Requiring consumers and insurance companies to resolve their controversies in an administrative forum rather than through litigation is the superior policy. As this Article has demonstrated, state courts, especially state supreme courts, are more likely to use litigants' demographic characteristics rather than sound legal principles to decide insurance-related actions. To satisfy the reasonable expectations of both consumers and insurance companies, and to ensure that conflicts are resolved fairly, quickly and on the merits, states must employ significantly larger numbers of administrative law judges. The expertise of such judges must be more than sufficient to adjudicate a wide variety of insurance-related issues.

States also could establish an effective enforcement strategy similar to the one created by the National Labor Relations Act (NLRA).¹⁷⁸ States' enforcement schemes should differ from the NLRA's in one respect: state complainants who complain about primary insurers' unfair and deceptive settlement practices must be barred from obtaining judicial review in either state or federal courts because extralegal factors, such as race, ethnicity, gender, types of aggrieved persons, complainants' occupational status, and vic-

174. See generally, A.B.A. *Bad-Faith Annotations*, *supra* note 171.

175. *Id.*

176. *Id.*

177. See SHERNOFF, *supra* note 42, at § 6.04[1][c].

178. National Labor Relations (Wagner) Act, 49 Stat. 449 (1935) (codified as amended at 29 U.S.C. §§ 141-187 (1988)). Under this Act, both the General Counsel and the National Labor Relations Board play major roles. 29 U.S.C. § 153(d) (1988). However, there is little reason to structure a state administrative system in which considerable discretion is given to a general counsel. A three-judge intermediate panel could be established to review administrative law judges' decisions if aggrieved insureds or primary carriers wished to appeal adverse rulings. And if the intermediate panel's ruling is unfavorable, the losing party could still appeal the action to one of several regional boards with the state. Each regional board would be comprised of five persons who are both insurance-law specialists and experienced litigators, and each regional board's decision board would be final.

tims' geographic origin, influence outcomes of actions.¹⁷⁹ Arguably, such unwarranted discriminatory conduct stems, in part, from justices' incompetence and lack of experience in complex areas of law.

V. CONCLUSION

Are state supreme courts truly biased against consumers of insurance products? Are most courts hostile toward primary insurance carriers? As this Article has demonstrated, many insurance companies and consumers believe that judicial bias is rampant in state supreme courts. Apparently, both insureds' and insurers' opinions have been shaped by conflicting interpretations of dicta appearing in various bad-faith, breach-of-contract, breach-of-covenant-of-good-faith, and excess-judgment decisions.

On the basis of the findings reported in this Article, state supreme courts are practicing disparate-impact discrimination, a type of "judicial bias." These tribunals are unwittingly permitting immaterial evidence to influence the outcome of bad-faith, breach-of-contract, breach-of-covenant-of good-faith and excess-liability actions.

State legislatures must establish effective and "unbiased" administrative enforcement systems to address claims-settlement and other insurance-related disputes between primary carriers and their insureds. Until such mechanisms are in place, insureds as well as insurers are likely to remain victims of disparate-impact discrimination in state supreme courts.

179. See, e.g., Rice, *Enforcement Under Labor Acts*, *supra* note 157, at 727-34; Rice, *Fair Housing*, *supra* note 149, at 248-63; Rice, *Grove-City Analysis*, *supra* note 157, at 283-96.