2760 BAD FAITH BY INSURANCE COMPANY (EXCESS VERDICT CASE)

A policy of insurance is a contract between the insurance company and the person who buys the policy, who is known as the "insured." Under the terms of a policy, the insurance company reserves the right to exclusively control the defense of a claim filed by an injured party against the insured and the company. If the claim or demand is less than the limits of the policy, normally the insured is excluded from interfering in any way in the investigation and the negotiations for settlement of the claim and has no voice in the legal procedures to be followed by the insurance company in defending the claim filed against him or her and the insurance company.

Thus, so long as the ultimate settlement or recovery by the injured party does not exceed the monetary limits of the insured's policy, the question of whether the claim should be settled or the manner in which it is defended usually is of no concern to the insured.

When, however, an injury does occur and a claim or demand is made, which should alert the insurance company that the injured party's recovery might exceed the insured's policy limits, then the interest of the policyholder must become a matter of concern to the insurance company.

At this point, certain duties on the part of an insurance company do arise. Stated generally, it is a duty to exercise ordinary care in the handling of the injured party's claim to the end that the insured's interest will be protected. This duty arises because the insured, by virtue of the policy with the insurance company, has agreed to let the company investigate and defend the claim, has given the insurance company the exclusive right to settle or compromise the claim, has given the company complete control in the defense of the claim,

and further has agreed not to participate except at his or her own expense by hiring his or her own lawyer to represent him or her on any financial risk above the limits in the policy.

Because of this relationship, an insurance company has the following duties to its insured in handling an injured party's claim filed against it and the insured:

1. To conduct an investigation of the facts and circumstances of the accident by all available and reasonable means, as well as to inform itself of the nature and extent of the injuries sustained by an injured party and the extent to which the injured party has recovered from those injuries. [This duty includes gathering information about who was at fault in causing the accident, which would include interviewing witnesses to the accident or taking or attending depositions of those persons who had personal knowledge of the facts necessary to make an overall evaluation of the case.]

On the basis of all information learned from its investigation, the company then must make a reasonable appraisal of the injured party's chances of winning if the lawsuit should go to trial and the amount of damages the injured party will probably recover against it and the insured if the case were tried.

2. The further duty to advise its insured if it is satisfied from the investigation and evaluation of all the facts that it appears probable that the injured party will recover an amount in excess of the policy limits so that the insured can take appropriate and timely action for his or her own protection. (This could involve the insured's desire to retain his or her own lawyer to represent him or her on any probable monetary claim above the policy limits.)

3. To timely and adequately advise the insured of any and all meaningful negotiations for settlement between the company and the injured party, particularly of any offers and counter-offers of settlement.

The proper fulfillment of these obligations which I have just given to you imposes upon an insurance company a duty to act fairly and reasonably toward its insured at all stages of its investigation and in the handling of the defense of the injured party's claim. To put it another way, the insurance company must use reasonable diligence, which means such care and diligence as the ordinarily prudent insurance company would use under like or similar circumstances in investigating, evaluating, defending, and negotiating on behalf of its insured. While there is no requirement that an insurance company must absolutely exhaust all sources of information, it is required to exercise reasonable care and diligence to that end.

In answering question 1, the burden of proof is on (plaintiff) to satisfy you, by the greater weight of the credible evidence, to a reasonable certainty, that the question should be answered "yes."

Question 2 reads as follows: "If you have answered question 1 'yes,' then answer this question. Did the failure of the insurance company to perform its duties to its (plaintiff), as found in question 1, demonstrate such a significant disregard of (plaintiff)'s interests that the insurance company's final decision not (to pay policy limits) to settle the case was made in bad faith?"

In answering question 2, you are now called upon to determine whether the company's refusal to settle the case (for policy limits), and thereby expose its insured to a judgment over the policy limits, was made in bad faith.

"Bad faith" is a term of broad application, and it is sometimes difficult to exactly define within the framework of every case. The term "bad faith" carries with it a suggestion of dishonest or deceitful conduct. In deciding whether the insurance company acted in bad faith in this case, you should carefully consider whether the company, in failing to perform the duties it owed to (plaintiff), demonstrated a significant disregard of (plaintiff)'s rights and economic interests.

In deciding not (to pay (plaintiff)'s policy limits) to settle the case, you are advised that an insurance company, because it has the right to exercise its own judgment whether the claim should be contested or settled, has an obligation to its insured to make an informed and reasonable judgment.

Its conduct should be accompanied by considerations of good faith. Its decision not to settle (by paying an insured's policy limits) should be an honest one, taking into consideration both the interest of the company and the interest of the insured. It should be the result of weighing of probabilities in a fair and honest way.

Even though you may have concluded that the insurance company acted negligently in the performance of its duties in your answer to question 1, that alone is not enough to show that the company acted in bad faith. Rather, you should consider the totality of the company's conduct in the handling of the injured party's claim to determine whether the company's decision to expose its insured to a judgment over the policy limits was an intellectually honest and reasonable decision. If you determine that it was not an honest and reasonable decision, then the company may be said to have acted in bad faith. On the other hand, if you conclude from all the evidence that the insurance company's decision not to settle the case was reasonable under the circumstances and made in the honest belief that the injured party's

claim could be defeated or that the damages could be kept within the insured's policy limits, then you should find that the insurance company did not act in bad faith in refusing to settle the case.

The burden of proof to satisfy you that question 2 should be answered "yes" is on (plaintiff). This means that (plaintiff) must satisfy you by evidence that is clear, satisfactory, and convincing, to a reasonable certainty, that (defendant insurance company) acted in bad faith toward (plaintiff) in the performance of its duties.

SPECIAL VERDICT

Question 1: Did (insurance company) acting through its lawyers breach any of the duties that it owed to its insured, (insured), in the handling of (injured party)'s claim against (insured) and the insurance company?

Answer:_____
Yes or No

Question 2: If you have answered question 1 "yes," then answer this question. Did the failure of (insurance company) to perform its duties to (insured), as found in question 1, demonstrate such a significant disregard of (injured)'s interests that the insurance company's final decision not to [pay policy limits to] settle the case was made in bad faith?

Answer:_____
Yes or No

COMMENT

This instruction was formerly Wis JI-Civil 3120. It was revised and renumbered in 1980 and revised in 1984 and 1991. This instruction was revised in 2002 to conform the language regarding the burden of proof to the Committee's 2002 revisions to Wis. JI-Civil 200 and 205, the instructions on the civil burdens of proof. See Wis. JI-Civil 200, Comment. The comment was revised in 1986, 1991, 1996, and 1998.

Under Wisconsin case law, an insurance company, owing to its fiduciary relationship with an insured, has certain well-defined duties to perform in the handling of a claim against its insured. These duties are as follows:

1. The duty to make a diligent effort to ascertain all of the facts of the accident upon which an informed and reasonable evaluation can be made of the claim against its insured;

2. The duty to advise its insured that the recovery could exceed policy limits so that the insured might take timely and independent action to protect his or her own interest; and

3. The duty to keep the insured timely and adequately informed of any offers of settlement made to the insurance company or its attorney and the progress of the settlement negotiations. (See Hilker v. Western Automobile Ins. Co., 204 Wis. 1, 231 N.W. 257 (1931), and Baker v. Northwestern Nat'l Casualty, 22 Wis.2d 77, 125 N.W.2d 370 (1963), and 26 Wis.2d 306,132 N.W.2d 493 (1965).) See also Kranzush v. Badger State Mut. Casualty Co., 103 Wis.2d 56, 307 N.W.2d 256 (1982).

These duties arise because the policy between the insurer and the insured gives the insurer complete control over the investigation, settlement negotiations, and, most importantly, the final decision whether to settle the case within policy limits. Mowry v. Badger State Mut. Casualty, 129 Wis.2d 496,510, 385 N.W.2d 171 (1986). If the case is settled within policy limits, there is no exposure to the insured and his or her rights under the policy are not violated.

Some members of the bench and bar believe that the ultimate question of bad faith rests solely upon negligence considerations and that there is no requirement to show any dishonest or deceitful conduct by an insurance company or its lawyers toward the insured. This view seems to be supported by dicta in Alt v. American Family Mut. Ins. Co., 71 Wis.2d 340, 354, 237 N.W.2d 706 (1976), in which the court states:

> While the Hilker case makes it clear that the liability of the insurance company in a situation such as this is for negligence, i.e., the breach of ordinary care in a fiduciary relationship, the burden of proof is higher than that required in most negligence cases. The claimant must assume the middle burden of proof, and the breach of the insurer's duty must be proved by clear and convincing evidence. The insurance company, however, to be liable, need not be found to have committed fraud or to have acted dishonestly in respect to its insured.

A close reading of Wisconsin decisions involving bad faith by an insurer shows that Wisconsin is committed to what Professor Keeton calls the "dual standard" in deciding excess verdict bad faith cases. The conduct of the insurance company in dealing with its insured (i.e., the manner in which it performs its duties to the insured) is conceptually a negligence question; its ultimate decision not to settle within policy limits is then properly one of good or bad faith. See Keeton, "Liability Insurance and Responsibility for Settlement," 67

Harv. L. Rev., 1136 (1954), and "Insurer's Excess Liability: Evaluating Conduct and Decision in Refusal of Settlement Offers," Rebecca Leair, FIC Quarterly/Summer 1983, pp. 371-396.

The Committee believes that the passage from Alt quoted above can only be reconciled with other Wisconsin cases by reading it to mean not that liability but rather that the performance of an insurance company's duties to its insured are tested by negligence law. The proper inquiry then is whether the insurance company, by act or omission, performed its duties as a reasonable insurance company would in the conduct of its own business.

If the trier of fact determines that the company has not acted as a reasonable insurer, then there has been a breach of fiduciary duty. However, the ultimate question of whether the company's refusal to settle the case within policy limits was made in bad faith can be answered only after giving overall consideration to the nature and extent of the company's acts of negligence. As stated in Baker v. Northwestern Nat'l Casualty Co., 26 Wis.2d 306, 315, 132 N.W.2d 493 (1965):

> The extent and character of the negligence, however, are factors to be considered by the trier of fact in weighing the matter of bad faith. To hold the carrier liable for the excess judgment, the insured must show by clear, satisfactory, and convincing evidence, that the carrier acted in bad faith.

If the trier of fact determines that the company's conduct was of a character to evince a significant disregard of its insured's rights, then it can be said to have acted in bad faith. The reason that this must be established by clear and satisfactory evidence is because the concept of bad faith under Wisconsin law is, and always has been, a species of fraud and carries with it the suggestion of the company's not having dealt fairly and honestly with its insured.

Based on its review of the case law, the Committee revised this instruction to more clearly present to the jury the two-step fact-finding process. If the jury concludes that the insurer has breached its duties to an insured to the extent that the breach evinces a significant disregard of the insurer's rights, then, under Wisconsin law, its conscious decision not to pay the insured's policy limits is deceitful and bad faith conduct. This process was approved in Warren v. American Family Mut. Ins. Co., 122 Wis.2d 381, 361 N.W.2d 724 (Ct. App. 1984).

The suggested special verdict has also been revised so that two questions, rather than one, are presented. The first question deals with the conduct of the insurer; the second question deals with the insurer's decision. The Committee believes this two-question verdict most clearly presents the "dual standard" and avoids begging the question by including the term "bad faith" in the same question which asks whether the insurance company breached any of its duties. For this reason, two separate questions are necessary.

It is not bad faith for an insurer to refuse an offer of settlement within policy limits when the question of policy coverage is fairly debatable. See Mowry v. Badger State Mut. Casualty, supra.

Expert Witness Testimony. For the requirement of expert testimony in bad faith actions, see Weiss v. United Fire & Casualty Co., 197 Wis.2d 365, 541 N.W.2d 753 (1996). In that decision, the supreme court rejected a bright-line rule requiring expert testimony in all bad faith tort claims.

The court of appeals has held that insurers are responsible for the negligence of its attorneys in conducting the actual litigation of a case. Majorowicz v. Allied Mut. Ins. Co., 212 Wis.2d 513, 569 N.W.2d 472 (Ct. App. 1997). In this case, the insurer argued that only if an employer has the right to control an employee's performance may it be held vicariously liable, under traditional agency principles for that individual's conduct. Therefore, the insurer said the trial court had erred in holding it responsible for the negligence of its counsel in conducting the actual litigation in the case. It argued that an insurer has no right to control the independent professional judgment of the counsel it hires to defend its insured. Moreover, it asserted, because an insurer cannot practice law itself, its contractual duty to defend must be delegable. The court of appeals concluded, however, that an insurance company's contractual relationship with its insured to exercise good faith is not delegable. It said the nondelegable duty exception is based upon the theory that certain responsibilities of a principle are so important that the principle should not be permitted to bargain away the risks of performance. Majorowicz v. Allied Mut. Ins. Co., supra at 526. In Majorowicz, the trial judge modified the patterned bad faith jury instruction. It added the following language to Wis JI-Civil 2760:

> [an insurance company has more than a passive role, that in some circumstances at least, it has an affirmative duty to seize whatever reasonable opportunity may present itself to protect its insured from excess liability.]

The court of appeals in Majorowicz determined that the language that was added to the jury instruction was taken verbatim from Alt v. American Family Mut. Ins. Co., supra. The court of appeals held that this passage accurately summarized Wisconsin bad faith law and concluded that there was no err in the modified jury instruction.