

INSURANCE “BAD FAITH” LAW AFTER THE HURRICANES

**DUTIES OWED BY INSURANCE COMPANIES
AND POTENTIAL PENALTIES FOR
VIOLATION OF THOSE DUTIES**

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INTRODUCTION

The devastation of south Louisiana caused by Hurricanes Katrina and Rita has led to an unprecedented number of claims against insurance companies. This paper reviews Louisiana law governing statutory and jurisprudential obligations owed by insurance companies, including penalties that may be imposed on insurance companies which breach those obligations.

The vast majority of potential penalty claims arise in first-party insurance disputes. Third-party claimants have limited rights to recover penalties from another's insurance company.¹

First-Party Insurance versus Third-Party Insurance

First-party insurance protects an insured from certain damages to itself and to its property. Only the insured and the insurer are parties to first-party insurance disputes. In the event of a loss, the insured makes a claim with its insurer. If the claim is not resolved, the insured may institute litigation against the insurer seeking damages for breach of the insurance contract, as well as for extra-contractual damages and/or statutory penalties.²

First-party insurance includes several types of coverages: uninsured/underinsured motorist; property; life, health, accident and disability; employee dishonesty insurance; business interruption; builder's risk; title insurance; and surety bonds.³

¹ See: La. R.S. 22:658A(2)- (4); R.S. 22:1220B(1)- (4).

² *Clark v. McNabb*, 04-0005 (La. App. 3 Cir. 5/19/04) 878 So.2d 677; R.S.22:1220A.

³ Stephen S. Ashley, *Bad Faith Actions, Liability and Damages* § 1:06 (2004)

Third-party insurance protects an insured against its liability for damages suffered by a third party caused by the insured's legal fault. All insurance except for liability insurance can be characterized as first-party insurance.⁴

Sources of First-Party Insurance “Bad Faith” Claims

In Louisiana, every contract includes a duty of good faith and fair dealing.⁵ The types of recoverable damages resulting from a breach of contract are governed by the Civil Code.⁶

In addition to the Civil Code provisions applicable to all contracts, the Insurance Code allows the recovery of damages, penalties and attorney's fees from insurers under certain circumstances.⁷ These statutory provisions are not uniform regarding the types of prohibited conduct that constitute “bad faith” or the potential recovery for violation of the statutes.

Claims for benefits for life insurance contracts are governed by R.S. 22:656. Health and accident claims are governed by R.S. 22:657. All other types of insurance policies are

⁴ See, e.g., R. Jerry, II, *Understanding Insurance Law* § 13A[e], at 38-39 (1996)

⁵ Art. 1759. Good faith
Good faith shall govern the conduct of the obligor and the obligee in whatever pertains to the obligation.

Art. 1983. Law for the parties; performance in good faith
Contracts have the effect of law for the parties and may be dissolved only through the consent of the parties or on grounds provided by law. Contracts must be performed in good faith.

⁶ Civil Code Book III, Title IV, Section 8, Chapter 4, including articles 1995 - 2000.

⁷ This paper addresses only private causes of action. While the Louisiana Unfair Trade Practices Act permits the imposition of certain penalties, R.S. 22:1214(14) and R.S. 22:1217, that law does not create a private cause of action to recover those penalties. See: *Theriot v. Midland Risk Ins. Co.*, (On Rehearing) 95-2895 (La. 5/20/97), 694 So.2d 184, 189-193; *Alarcon v. Aetna Casualty and Surety Company*, 538 So.2d 696 (La. App. 3d Cir.1989).

governed by R.S. 22:658 and R.S. 22:1220.⁸

Types of Insurer Misconduct That Can Trigger Statutory Penalties

The statutory penalty provisions in the Insurance Code are similar, but not identical. In death cases, an insurer which fails to pay death benefits within sixty days after it receives “due proof of loss” will be subject to penalties, if the failure to pay is “without just cause.” R.S. 22:656.

In health and accident policies, penalties may be imposed against an insurer for nonpayment within thirty days after suitable proof of loss is received, unless “just and reasonable grounds” exist for the nonpayment, “such as would put a reasonable and prudent businessman on his guard.” R.S. 22:657B.

For all other insurance policies (except life insurance, accident and health insurance or worker’s compensation), R.S. 22:658⁹ and/or R.S. 22:1220¹⁰ are applicable. The time

⁸ Worker’s compensation bad faith claims are governed by the worker’s compensation law, Chapter 10 of Title 23 of the Louisiana Revised Statutes of 1950.

⁹ R.S. 22:658C applies to worker’s compensation cases. R.S. 23:1201I.

¹⁰ R.S. 22:1220D excludes only health and accident insurance policies from its coverage. The jurisprudence holds that R.S. 22:1220 is inapplicable to worker’s compensation cases. See: *Alford v. Travelers Ins. Co.*, 92-1414 (La. App. 4 Cir. 11/13/92) 609 So.2d 906, writ denied, 92-3207 (La.01/29/93) 613 So.2d 626; *Sneed v. Gilchrist Const. Co.*, 92-1024, (La. App. 3 Cir., 6/2/93) 619 So.2d 888.

As to life insurance, the jurisprudence is unclear. There are no reported decisions upholding an award of R.S. 22:1220 penalties against a life insurance company. However, the rejections of the statutory penalty claims were not based on a determination that R.S. 22:1220 is inapplicable to life insurance policies. Compare: *Klein v. American Life & Cas. Co.*, 01-2336 (La. App. 1 Cir. 6/27/03) 858 So.2d 527 (a violation of R.S. 22:1214(19) does not support a R.S. 22:1220 penalty claim); *Earthly v. United of Omaha Life Ins. Co.*, 04-104 (La. App. 3 Cir. 6/2/04) 878 So.2d 746 (issue raised prematurely);

period under R.S. 22:658 is the same as for health and accident policies (thirty days). The time period under R.S. 22:1220 is the same as for life insurance (sixty days).

The standard of insurer misconduct that may trigger the imposition of statutory penalties under both R.S. 22:658B(1) and R.S. 22:1220B(5)¹¹ is nonpayment that is “arbitrary, capricious or without probable cause.”

Despite the different phraseology regarding the type of insurer misconduct that triggers the statutory penalty provisions, the courts treat the standards as interchangeable.¹²

Statutory Penalties

Significant differences exist between the penalty provisions. For life insurance

Massachusetts Indem. and Life Ins. Co. v. Humphreys, 93-2025 (La. App. 1 Cir. 10/7/94) 644 So.2d 818 (beneficiary failed to prove that she sustained damages as a result of life insurer’s failure to pay within sixty days after receiving proof of death); *Bergeron v. Pan American Assur. Co.*, 98-2421 (La. App. 4 Cir. 4/7/99) 731 So.2d 1037 (at oral argument, plaintiffs conceded the inapplicability of R.S. 22:1220 to that case).

¹¹ See: *Sultana Corp. v. Jewelers Mut. Ins. Co.*, 03-0360 (La. 12/3/03) 860 So.2d 1112. (An insurer’s knowing failure to pay a settlement within thirty days is a breach of its R.S. 22:1220B(2) duty, regardless of whether the failure to pay was arbitrary and capricious; the legislature did not require proof of an arbitrary or capricious failure to timely pay settlement funds.

¹² See: *Crawford v. Blue Cross Blue Shield of Louisiana*, 99-2503, p. 11 (La. App. 1 Cir. 11/3/00) 770 So.2d 507, 515, writ denied 00-3267 (La. 2/16/01) 786 So.2d 98 ; *Houston v. Blue Cross and Blue Shield of Louisiana*, 37,097, p 8-9 (La. App. 2 Cir. 4/9/03), 843 So.2d 542, 548 (R.S. 22:657 penalty should not be assessed unless refusal to pay is clearly arbitrary and capricious), writ denied, 03-1342 (La. 9/19/03) 853 So.2d 641; and *Calogero v. Safeway Insurance Company of Louisiana*, 99-1625, p. 7 (La.1/19/00), 753 So.2d 170, 174. (The conduct prohibited by R.S. 22:658(A)(1) is virtually identical to the conduct prohibited in R.S. 22:1220(B)(5): the failure to timely pay a claim after receiving satisfactory proof of loss when that failure to pay is arbitrary, capricious, or without probable cause. The primary difference is the time periods allowed for payment.)

policies, the insurer must pay interest on the amount due under the policy from the date the insurer receives due proof of death until payment is made. R.S. 22:656.

The penalty for failure to pay benefits under a health and accident policies is double the amount of the health and accident benefits due under the terms of the policy during the period of delay, together with attorney's fees to be established by the court. R.S. 22:657A.¹³

If the health and accident policy also contains an accidental death benefit, the penalty is similar to the R.S. 22:656 penalty for life insurance policies - interest from the date of receipt of due proof of death. The six percent penalty interest rate for death benefits provided by a health and accident policy is lower than the eight percent penalty interest rate for life insurance policies. R.S. 22:657B.

The R.S. 22:658 penalty for "all other" policies was amended in 2003 and again in 2006.¹⁴ The 2006 amendment increased the penalty to "fifty percent damages on the amount found to be due from the insurer to the insured, or one thousand dollars, whichever is greater . . . or in the event a partial payment or tender has been made, fifty percent of the difference between the amount paid or tendered and the amount found to be due."¹⁵ For statutory violations occurring after August 15, 2006, attorney's fees are recoverable. Attorney's fees are not recoverable for statutory violations that occurred between the effective dates of the

¹³ Where health and accident insurance coverage is provided to an insured through an employee benefit plan, the provisions of R.S. 22:657 are preempted by ERISA. See: *Ussery v. United Health Care Ins. Co.*, 04-2125 (U.S.D.C., E.D.La.12/7/05) Not Reported in F. Supp.2d, 2004 WL 2984331.

¹⁴ Acts 2003, No. 790, § 1. Acts 2006, No. 813 (effective 8/15/06).

¹⁵ R.S. 22:658(B)(1).

2003 and 2006 amendments to R.S. 22:658.¹⁶

R.S. 22:1220A allows an insured to recover all compensatory damages resulting from its insurer's breach of its obligations contained in that statute. Additionally, R.S. 22:1220C subjects the insurer to potential penalties "in an amount not to exceed two times the damages sustained or five thousand dollars, whichever is greater."

R.S. 22:1220C Penalties May Be Awarded, Even If No Actual Damages Are Caused by the Insurer's Breach of its R.S. 22:1220B Duties.

Before *Sultana Corp. v. Jewelers Mut. Ins. Co.* 03-0360 (La.12/3/03), 860 So.2d 1112, the intermediate appellate courts were split on whether R.S.22:1220C penalties were recoverable, if the insured failed to prove that it sustained some actual damages as a result of the insurer's violation of R.S. 22:1220. In *Sultana*, the Court held that R.S. 22:1220C penalties may be awarded for an insurer's breach of R.S. 22:1220, even without proof that the insured suffered general or special damages as a result of the insurer's breach of its statutory duties. *Sultana*, at p. 8 - 9, 860 So.2d at 1118-1119.

Overlap Between "Bad Faith" Penalty Statutes

Recognizing that R.S. 22:658A(1) and R.S. 22:1220B(5) overlap, the Supreme Court affirmed an award of attorney's fees pursuant to the pre-2003 version R.S. 22:658B(1) and

¹⁶ Between those dates, only R.S. 22:657 (health and accident policies) authorized an award of attorney's fees against an insurer. R.S. 22:657 attorneys fees were upheld in *Houston v. Blue Cross Blue Shield of Louisiana*, 37,097 (La. App. 2 Cir. 4/9/03), 843 So.2d 542.

In *Geraci v. Byrne*, 06-58 (La. App. 5 Cir. 6/28/06) 934 So.2d 263, the 2003 amendment to R.S. 2:658 was not given retroactive effect.

the award of the higher statutory penalties under R.S. 22:1220C in *Calogero v. Safeway Insurance Company of Louisiana, supra*. (Recovery of duplicate statutory penalties for the same misconduct under both statutes is impermissible. Where the statutory penalties are different, the insured may recover all non-duplicative penalties).

Should an insured assert a R.S. 22:658 statutory penalty claim, as well as seeking the potentially greater statutory penalties contained in R.S. 22:1220? There are several situations in which “bad faith” claims under both R.S. 22:658B(1) and R.S. 22:1220C should be asserted.

First, for claims arising before August 15, 2003 (the effective date of the 2003 amendment to R.S. 22:658) or after August 15, 2006 (the effective date of the 2006 amendment to R.S. 22:658), attorney’s fees may be awarded pursuant to R.S. 22:658 in addition to the greater of the statutory penalties awarded under either R.S. 22:658 or R.S. 22:1220. *Calogero, supra*.

Second, the two statutes have different time periods before the insurer’s inaction triggers its potential exposure to statutory penalties. If the insurer arbitrarily, capriciously or without probable cause fails to comply with its obligations for more than thirty, but less than sixty, days after receiving a “satisfactory proof of loss,” only R.S. 22:658 is applicable.

Third, the statutory penalty provisions of R.S. 22:658B(1) are mandatory. At one time, there was an issue as to whether R.S. 22:1220C statutory penalties are mandatory or discretionary. Compare *Calogero, supra*, (“ . . . unlike penalties under La. R.S. 22:1220, subd. C, penalties and attorney fees under La. R.S. 22:658, subd. B(1) are mandatory, rather

than discretionary, where a breach of La. R.S. 22:658, subd. B(1) has occurred” . . .) with the Supreme Court’s later decision in *Reed v. State Farm*, 03-0107 (La. 10/21/03), 857 So.2d 1012, 03-0107 (La. 10/21/03) at footnote 11:

The parties point out there is a split in the circuit courts regarding whether the penalty in LSA-R.S. 22:1220 is mandatory or discretionary. *See for example, Reed*, 02-804 at 10, 832 So.2d at 1140; *The Sultana Corporation v. Jewelers Mutual Insurance Company*, 01-2059, p. 2 (La. App. 1 Cir. 12/31/02), 837 So.2d 134, 136, *writ granted*, 03-0360 (La. 4/25/03), 842 So.2d 387; *Harrington v. Cato Corporation*, 32,055, pp. 3-4 (La. App. 2 Cir. 6/16/99), 740 So.2d 732, 735; *Adams v. Stratton*, 02-224, p. 4 (La. App. 5 Cir. 10/16/02), 831 So.2d 290, 291, *writ denied*, 02-2792 (La.2/7/03), 836 So.2d 101. Because we resolve the instant case by concluding there was no violation of the statutes by State Farm, this is not the proper forum in which to address the split in the appellate court decisions.

In *Sultana Corp. v. Jewelers Mut. Ins. Co.*, 03-0360, page 5 (La. 12/3/03) 860 So.2d 1112, 1117, the Supreme Court apparently¹⁷ resolved this issue:

. . . *Compare* Subsection (A) of La.Rev.Stat. Ann. § 22:1220 which states that “[a]ny insurer who breaches these duties *shall* be liable for any damages sustained as a result of the breach.” (emphasis added). Simply stated, even though the award of general or special damages, if requested, is mandatory, **the trial court's grant of penalties under Subsection C of La. Rev. Stat.**

¹⁷ The quoted portion of this decision is *dicta*. The issue before the Court was whether the insured must prove that it suffered damages as a result of the insurer’s violation of R.S. 22:1220B(2), as a prerequisite for the award of penalties under R.S. 22:1220C.

The Court did not mention *Reed, supra*, decided only six weeks earlier, in which it recognized the split between the lower courts as to whether R.S. 22:1220C penalties are mandatory or discretionary.

Also, the *Sultana* parties did not contest this issue:

Although the litigants are in general agreement with the mandatory award of damages under Subsection A and the permissive nature of the penalty award under Subsection C

Sultana, supra, at p. 6, 860 So.2d at 1117

Ann. § 22:1220 is discretionary. . . .

[Emphasis added].

Fourth, the potential penalties pursuant to R.S. 22:1220C¹⁸ could be substantially greater than the penalties provided by R.S. 22:658B(1).¹⁹

What Must an Insured Prove to Establish a First-Party “Bad Faith” Claim?

An insured seeking first-party statutory penalties pursuant to R.S. 22:658B(1) and/or R.S. 22:1220B(5)/22:1220C has the burden of proving three things: (1) that the insurer received a satisfactory proof of loss, (2) that the insurer failed to pay the claim within the applicable statutory period, and (3) that the insurer's failure to pay was arbitrary and capricious. *Boudreaux v. State Farm Mut. Auto. Ins. Co.*, 04-1339, p.4 (La. App. 4 Cir. 2/2/05) 896 So.2d 230, 233.

Boudreaux cites *Sterling v. U.S. Agencies Casualty Co.*, 01-2360, p. 6 (La. App. 4th Cir. 5/15/02) 818 So.2d 1053, 1057, for this point. Ironically, the stated test was correct for *Boudreaux*, a R.S. 22:1220B(5) penalty case, but the “arbitrary and capricious” requirement was unnecessary in *Sterling*, a R.S. 22:1220B(2) penalty case.

¹⁸ In addition to any general or special damages to which a claimant is entitled for breach of the imposed duty, the claimant may be awarded penalties assessed against the insurer in an amount not to exceed two times the damages sustained or five thousand dollars, whichever is greater.

¹⁹ . . . shall subject the insurer to a penalty, in addition to the amount of the loss, of twenty-five percent damages on the amount found to be due from the insurer to the insured, or one thousand dollars, whichever is greater. . . .

In *Sterling*, the Fourth Circuit affirmed an award of statutory penalties pursuant to R.S. 22:1220B(2) - “Failing to pay a settlement within thirty days after an agreement is reduced to writing.” Even though the *Sterling* court concluded that the insurer’s actions were “arbitrary and capricious,” that statutory requirement is found only in R.S. 22:658B(1) and in R.S. 22:1220B(5). Statutory penalties in *Sterling* would have been proper, even if the insurer’s actions had not been “arbitrary and capricious.”

For an insurer’s violation of any sub-part of R.S. 22:1220B, other than R.S. 22:1220B(5), proof that the insurer’s actions were “arbitrary, capricious or without probable cause” should not be necessary. *Sultana Corp. v. Jewelers Mut. Ins. Co., supra.*

What is a “Satisfactory Proof of Loss”?

The phrase “satisfactory proof of loss” is not defined in any of the “bad faith” statutes. No specific form or mandatory information is required by the jurisprudence interpreting these statutes.²⁰

In uninsured/underinsured motorists coverage cases, the meaning of “satisfactory proof of loss” in R.S. 22:658B(1) and R.S. 22:1220B(5) is well established. *McDill v. Utica Mutual Ins. Co.*, 475 So.2d 1085 (La.1985), defined a R.S. 22:658 “satisfactory proof of loss” in the context of a UM coverage claim. In order to establish that the insurer received a satisfactory

²⁰ R.S. 22:650 mandates that: any insurer that requires completion of a proof of loss form must furnish such form to any person claiming to have a loss under any insurance contract. But the insurer shall not, by reason of the requirement so to furnish forms, have any responsibility for or with reference to the completion of such proof or the manner of any such completion or attempted completion.

proof of loss in a UM claim:

. . . the insured must show that the insurer received sufficient facts which fully apprise the insurer that (1) the owner or operator of the other vehicle involved in the accident was uninsured or under insured; (2) that he [or she] was at fault; (3) that such fault gave rise to damages; and (4) establish the extent of those damages.

McDill, 475 So.2d 1085, 1089.

A less-demanding test is used in other types of first-party statutory “bad faith” claims.

A handwritten estimate of repairs on fire-damaged residence given by contractor to insurance adjuster was a satisfactory proof of loss under a homeowner's policy. *Sevier v. U.S. Fidelity & Guar. Co.*, 86-C-0801 (La.11/24/86) 497 So.2d 1380. The Supreme Court explained:

The cases under section 658 have demonstrated that “proof of loss” is a flexible requirement to advise the insurer of the facts of the claim. *Austin v. Parker*, 672 F.2d 508, 520 (5th Cir.1982); *Spalitta v. Hartford Fire Insurance Co.*, 428 So.2d 824, 827 (La. App. 5th Cir.1983); *Riverland Oil Mill, Inc. v. Underwriters for Lloyd's, New York*, 368 So.2d 156, 163 (La. App. 2d Cir.), writ denied, 369 So.2d 1365 (La.1979). The proof of loss is not required to be in any formal style. *Gatte v. Coal Operators Casualty Co.*, 225 So.2d 256, 258 (La. App. 3d Cir.1969), rev'd on other grounds, 256 La. 325, 236 So.2d 485 (1970) (citing *Moore v. St. Paul Fire & Marine Insurance Co.*, 193 So.2d 882 (La. App. 3d Cir.1967)). As long as the insurer receives sufficient information to act on the claim, “the manner in which it obtains the information is immaterial.” *Austin v. Parker*, 672 F.2d at 520.

Sevier, 497 So.2d at 1384.

In *Carter v. Safeway Ins. Co.*, 37,788 (La. App. 2 Cir. 10/29/03), 859 So.2d 279, the insured sought to recover for property damage to her automobile from her auto insurer. The insured's automobile had been stolen and was discovered burned two days later. On the day the vehicle was found, the insured notified the insurer of the incident. The insurer sent a

representative to meet with the insured and take a statement from the insured.

Rejecting the insurer's contention that it did not receive a "satisfactory proof of loss" pursuant to R.S. 22:658B(1), the Court explained

The purpose of the "proof of loss" prerequisite for making such a claim is to make certain that an insurer has adequate knowledge of the loss suffered by the insured such that the insurer can properly adjust the claim. There are no formal requirements for the manner in which "proof of loss" is to be made and the manner in which the insured obtains the information is immaterial. *Hershell Corp. v. Fireman's Fund Ins. Co.*, 98-1352 (La. App. 3d Cir.6/2/99), 743 So.2d 698.

Carter, supra at p. 10, 859 So.2d at 285

The insurer's hiring of an independent property adjuster to determine the extent of hail damage to the roofs of an insured's barn and house satisfied the "satisfactory proof of loss" requirement of R.S. 22:1220B(5). *Becnel v. Lafayette Ins. Co.*, 99-2966, p. 9-10 (La. App. 4th Cir. 11/15/00) 773 So.2d 247, writ denied 00-3458 (La. 2/9/01) 785 So.2d 827.

What Does "Arbitrary, Capricious or Without Probable Cause" Mean?

The phrase that triggers an insurer's potential exposure to statutory penalties pursuant to R.S. 22:658B(1) and R.S. 22:1220B(5) is "arbitrary, capricious or without probable cause." While "bad faith" is often used as a short-hand reference for "arbitrary, capricious or without probable cause," the two phrases have different meanings.

In *Vaughn v. Franklin*, 00-0291, page 7 (La. App. 1 Cir. 3/28/01) 785 So.2d 79, 85, writ denied 01-1551 (La. 10/5/01) 798 So.2d 969, the court discussed the difference between "bad faith" and "arbitrariness":

Bad faith means more than mere bad judgment or negligence; it implies a dishonest purpose or evil intent. *Bond v. Broadway*, 607 So.2d 865, 867 (La. App. 2nd Cir.1992), *writ denied*, 612 So.2d 88 (La.1993). Arbitrariness is a more venial offense; it is a willful and unreasoning action, without consideration for the facts and circumstances presented, or acting with unfounded motivation. *See Brown v. Texas-LA Cartage*, 98-1063, pp. 8-9 (La.12/1/98), 721 So.2d 885, 890. An insurer's action in handling a claim is arbitrary when its willful refusal of a claim is not based on a good-faith defense. *Calogero v. Safeway Ins. Co.*, 99-1625, p. 5 (La.1/19/00), 753 So.2d 170, 173.

Vaughn's recognition of the difference between "bad faith" and "arbitrary and capricious" conduct by an insurer is not new. "The words arbitrary and capricious ... do not necessarily imply an opprobrious connotation." *Steadman v. Pearl Assurance Co.*, 167 So.2d 527, 531 (La. App. 4 Cir.1964). Rather, arbitrary conduct merely "implies an abuse of one's authority or power." *Id.*

In its most recent statutory "bad faith" decision, the Supreme Court discussed the meaning of the "arbitrary, capricious and without probable cause" statutory provisions. In footnote 7 in *Reed v. State Farm, supra*, at p. 13, 857 So.2d at 1020, the Court began its analysis by dismissing the frequent misquotation of the applicable phrase:

We note the jurisprudence generally uses the terms "arbitrary and capricious" despite the fact the statutory provisions use the disjunctive "arbitrary, capricious, or without probable cause." Regardless, the definitions of the terms "arbitrary" and "capricious" are almost indistinguishable from each other. An "arbitrary" act is an act "based on random choice or personal whim, rather than any reason or system." THE NEW OXFORD AMERICAN DICTIONARY 80 (Elizabeth J. Jewell & Frank Abate eds., 2001). "Capricious" action is "given to sudden and unaccountable changes of behavior." *Id.* at 256. A judicial "decision founded on prejudice or preference rather than on reason or fact" is often termed "arbitrary and capricious." BLACK'S LAW DICTIONARY 100 (7th ed.1999).

Later in that opinion, the Court explained that an insurer's misconduct meets the "arbitrary, capricious or without probable cause" standards of R.S. 22:658B(1) and R.S. 22:1220B(5) when the insurer's actions are unjustified, lack a reasonable basis or are without probable cause or excuse.

The sanctions of penalties and attorney fees are not assessed unless a plaintiff's proof is clear that the insurer was in fact arbitrary, capricious, or without probable cause in refusing to pay. *Block v. St. Paul Fire & Marine Ins. Co.*, 32,306, p. 7 (La. App. 2 Cir. 9/22/99), 742 So.2d 746, 751. The statutory penalties are inappropriate when the insurer has a reasonable basis to defend the claim and acts in good-faith reliance on that defense. *Rudloff v. Louisiana Health Services and Indemnity Co.*, 385 So.2d 767, 771 (La.1980), *on rehearing*. Especially when there is a reasonable and legitimate question as to the extent and causation of a claim, bad faith should not be inferred from an insurer's failure to pay within the statutory time limits when such reasonable doubts exist. *Block*, 32,306 at 8, 742 So.2d at 752.

Both LSA-R.S. 22:658 and LSA-R.S. 22:1220 require proof that the insurer was "arbitrary, capricious, or without probable cause,"^{FN8} a phrase that is synonymous with "vexatious." *Louisiana Maintenance Services, Inc. v. Certain Underwriters at Lloyd's of London*, 616 So.2d 1250, 1253 (La.1993). This court has noted that "vexatious refusal to pay" means unjustified, without reasonable or probable cause or excuse. *Id.*, *citing* COUCH ON INSURANCE 2d, § 58:70. Both phrases describe an insurer whose willful refusal of a claim is not based on a good-faith defense. *Id.*

FN8. The same language is used in the workers' compensation law. For example, reasonable attorney fees are awarded as a penalty when an employer discontinues payment of benefits if the "discontinuance is found to be arbitrary, capricious, or without probable cause." LSA-R.S. 23:1201.2. In that context, this court has defined arbitrary and capricious behavior as "willful and unreasonable action, without consideration and regard for the facts and circumstances presented." *J.E. Merit Constructors, Inc. v. Hickman*, 00-0943, p. 5 (La.1/17/01), 776 So.2d 435, 437.

Reed, Id., at 13 - 14, 857 So.2d at 1021.

Unconditional Tender

R.S. 22:658 A(1) requires that “[a]ll insurers issuing any type of contract [other than life, health and accident and workers compensation policies] shall pay the amount of any claim due any insured within thirty days after receipt of satisfactory proofs of loss from the insured or any party in interest.” However, R.S. 22:658B(1) limits the statutory penalties for an insurer’s violation of R.S.22:658A(1) to situations in which the insurer’s actions are “arbitrary, capricious or without probable cause.”

The majority of litigation regarding this statutory provision has arisen in UM cases. *McDill v. Utica, supra*, and its progeny interpret R.S. 22:658 A(1) and R.S. 22:658 B(1) to require the UM insurer that has received a “satisfactory proof of loss” to make an “unconditional tender” of the amounts covered by the policy as to which “reasonable minds cannot disagree.” See *Genusa v. Robert*, 98-449 (La. App. 5 Cir. 10/14/98) 720 So.2d 166, 172-173.

When a reasonable dispute exists between the insurer and the insured as to the amount of a loss, the insurer's refusal to pay is not arbitrary, capricious or without probable cause. However, if part of a claim for damages is undisputed, the failure of the insurer to pay the undisputed portion of the claim within the statutory delay will subject the insurer to liability for penalties. To avoid the imposition of penalties and attorney's fees, the insurer must unconditionally tender to the insured that part of the claim that is not disputed. *Patin v. Imperial Lloyds Ins. Co.*, 95-841, p. 11 (La. App. 3 Cir. 1/17/96), 670 So.2d 238, 244.

The R.S. 22:658A(1) requirement for an unconditional tender of the undisputed portion of a covered loss is not limited to UM claims. In *Dufrene v. Imperial Fire and Cas. Ins. Co.*, 03-1001 (La. App. 5 Cir. 2/10/04) 866 So.2d 380, writ denied 04-0891 (La. 5/21/04) 874 So.2d 176, R.S. 22:658B(1) statutory penalties were awarded against a negligent driver's auto liability insurer that violated its R.S. 22:658A(4) obligation to make an appropriate tender for a third-party property damage claim.

In *Carter v. Safeway Ins. Co.*, *supra*, a similar R.S. 22:658B(1) statutory penalty award was affirmed against the insured's auto insurer in a first-party property damage claim. In *Carter*, the insurer contended that it was reasonable to rely on a "forcible entry" exclusion for coverage as the basis for its refusal to pay the loss "under the suspicious circumstances" concerning the loss in question. The Court rejected that argument, noting that the insurer offered no evidence on which one could base a good faith belief that the cited exclusion was applicable, nor did it present any evidence that its insured was involved in the loss. *Carter*, *supra* at p. 10-11, 859 So.2d at 285-286.

The tender of the amount of damages to which reasonable minds cannot disagree must be "unconditional." An offer of payment tied to a complete release of the insured's claim is not an unconditional tender required by R.S. 22:658. *Hayes v. Allstate Ins. Co.*, 99-1558 (La. App. 3 Cir. 3/1/00) 758 So.2d 900, writ denied 00-1587 (La. 8/31/00) 766 So.2d 1280.

Misrepresentation of Coverage

One common dispute in "bad faith" litigation arises when the insurer denies that its

policy provides coverage to its insured for the claimed loss. In the statutory context, the insurer's denial of coverage may raise the issue of whether the insurer's action violates its R.S. 22:1220B(1) duty not to misrepresent "pertinent facts or insurance policy provisions relating to any coverages at issue."

When an insurer refuses to pay a claim based on its interpretation of its policy's coverage for that claim, the jurisprudence does not provide a "bright line" test to decide whether the insurer has violated R.S. 22:1220B(1). When the denial is based on a reasonable and legitimate dispute "as to the extent and causation of a claim," bad faith should not be inferred from an insurer's failure to pay within the statutory time limits. *Reed v. State Farm Mut. Auto. Ins. Co.*, *supra*, at p. 13, 857 So.2d at 1021 (citing *Block v. St. Paul Fire & Marine Ins. Co.*, 32,306, p. 7 (La. App. 2 Cir. 9/22/99), 742 So.2d 746, 751).

However, an insurer that rejects a claim based on its misinterpretation of its policy's coverage may be liable for statutory penalties. In *Dawson Farms, L.L.C. v. Millers Mut. Fire Ins. Co.*, 34,801, p. 4-5 (La. App. 2 Cir. 8/1/01) 794 So.2d 949, 852, writs denied 01-2477 (La. 12/07/01) 803 So.2d 34 and 01-2497(La. 12/07/01) 803 So.2d 37, the court initially rejected the insurer's interpretation of its "all risk" property damage policy:

The test for construing an insurance policy is not what the insurer *er* intended the words to mean, but, how the words would have been understood by a reasonable person in the shoes of the insurer *ed*. The policy should be read as a layman would have read it and not as it might be analyzed by an insurance expert. The plain and obvious meaning of the words should be used in determining the coverage provided under the policy. All doubts and ambiguity should be resolved in favor of coverage. *Crocker, supra*. [*Crocker v. Roach*, 33,507 (La. App. 2d Cir. 08/23/00) 766 So.2d 672, writ denied 00-2684 (La.11/17/00) 774 So.2d 983.]

The appellate court then assessed statutory penalties against the “all risk” property damage insurer that contested that its policy provided coverage for the loss:

An insurer's liability to pay penalties and attorney fees is based on whether its action in denying coverage is arbitrary, capricious and without probable cause. The insurer must take the risk of misinterpreting its policy provisions; if it errs in interpreting its own insurance contract, such error will not be considered as reasonable ground for delaying payment of benefits, and it will not relieve insurer of payment of penalties and attorney fees. *Carney v. American Fire & Indemnity Co.*, 371 So.2d 815 (La.1979).

Dawson, at p. 7-8, 794 So.2d at 953.

Shrader v. Life General Sec. Ins. Co., 22,795 (La. App. 2 Cir. 10/30/91) 588 So.2d 1309, writ denied 91-2981 (La. 2/14/92) 592 So.2d 1317, presented a R.S. 22:657 penalty claim. After recognizing that normally the risk of misinterpreting its policy remains on the insurer, even if the policy provision has never been subject to a judicial interpretation, the court upheld the lower court’s refusal to award statutory penalties. In *Shrader*, the insurer’s incorrect construction of its policy’s coverage was supported by an opinion from the insurance commissioner’s office. The combination of the lack of jurisprudence, combined with the insurance commissioner’s opinion, provided a reasonable basis upon which the insurer was entitled to rely without facing statutory penalties.

An interesting “misrepresentation of coverage” decision is *McGee v. Omni Ins. Co.*, 02-1012 (La. App. 3 Cir. 3/5/03) 840 So.2d 1248, writs denied 03-1375 (La. 12/12/03) 860 So.2d 1149 and 03-1382 (La. 12/12/03) 860 So.2d 1149. After recognizing that in *Theriot v. Midland Risk, supra*, the Supreme Court limited the specific acts of “bad faith” to those enumerated in R.S. 22:1220B, the court concluded that the insurer had breached R.S.

22:1220B(1)'s proscription of "misrepresentation of coverage" by an insurer. The insurer's denial that its policy provided coverage for legal interest was clearly a misrepresentation of coverage.

However, the court also concluded that the insurer's consistent failure to keep the insured advised of the status of the litigation and its failure to communicate the "pertinent facts" necessary for the insured to determine what was in her personal interest constituted a violation of R.S. 22:1220B(1). "**Misrepresentation can occur when an insurer either makes untrue statements to an insured concerning pertinent facts or fails to divulge pertinent facts to the insured.**" *McGee v. Omni Ins. Co.*, at p. 11, 840 So.2d at 1256.

Compare *Fleming v. American Auto. Ass'n, Inc.*, 1999-1638 (La. App. 4 Cir. 6/21/00), 764 So.2d 274, in which a R.S. 22:1220B(1) misrepresentation of coverage claim was rejected because the insurer's actions were not deemed "arbitrary and capricious," with the Supreme Court's later decision in *Sultana Corp. v. Jewelers Mut. Ins. Co.*, *supra*, which held that R.S. 22:1220B(2) does not require proof that the insurer was "arbitrary and capricious" in its failure to comply with that subpart of the statute.²¹

The Fourth Circuit's incorrect interpretation of R.S. 22:1220B(1) to require proof of the insurer's "bad faith" was unfortunate for Ms. Fleming. The court affirmed a

²¹ While *Sultana* dealt with R.S. 22:1220B(2) and *Fleming* dealt with R.S. 22:1220B(1), that fact should not compel a different result. The Supreme Court in *Sultana* expressly noted that only R.S. 22:1220 B(5) requires proof that the insurer's conduct was "arbitrary, capricious or without probable cause. The only requirement for the other subparts of R.S. 22:1220B is that the insurer's act be "knowingly committed." See: *Sultana*, at p. 9, 860 So.2d at 1119.

\$1,000,000.00 general damage award against the travel insurer. Although the amount of a R.S. 22:1220C penalty apparently²² is discretionary, the potential R.S. 22:1220C penalty in *Fleming* could have been as high as an additional \$2,000,000.00.

Defenses to Bad Faith Claims

There are several defenses available to an insurer facing a statutory penalty claim. The following is a discussion of some common defenses to a “bad faith” claim.

- *There must be a valid underlying claim, before the insurer’s allegedly improper actions may trigger statutory penalties.*

Robin v. Allstate Ins. Co., 02-689 (La. App. 3 Cir. 2/5/03) 844 So.2d 41, arose out of an earlier action in which an excess policy limits judgment had been rendered against the insured husband. *Robin* involved a claim by an insured driver and his wife for various damages, including statutory penalties, against their auto liability insurer.

In upholding an exception of no right of action against the insured driver’s wife, the court noted that although she was insured under the Allstate policy, she had not been sued in the underlying tort action. Therefore, Allstate owed no duties to her under the insurance policy.

The court recognized that an insurer’s obligation arising out of the statutory penalty

²² See the discussion of *Sultana* in footnote 14 and the related text.

statutes is separate from its obligations arising out of the insurance policy.²³ However, in the absence of a valid claim against her insurer under its insurance policy, the wife had no right of action to recover statutory penalties from the insurer. *Robin*, p. 5-6, 844 So.2d at 46.

- *The refusal to pay was reasonable, even if wrong.*

Kottle v. Provident Life and Acc. Ins. Co., 34,099, p. 26 - 27 (La. App. 2 Cir. 12/15/00) 775 So.2d 64, 79, writ denied 01-0490 (La. 4/20/01) 790 So.2d 635, was a R.S. 22:657 disability insurance dispute. Even though the insured recovered benefits under the policy, the appellate court affirmed the denial of statutory penalties, finding that the factual issues presented in that case provided “reasonable grounds” for the insurer to dispute its obligation to pay benefits.

- *Where the insured withholds necessary information, it fails to provide a “satisfactory proof of loss.”*

Boudreaux v. State Farm Mut. Auto. Ins. Co., 04-1339 (La. App. 4 Cir. 2/2/05), 896 So.2d 230, was a first-party UM claim. Although the insured advised the UM insurer in a handwritten note that she had undergone a lumbar fusion, she failed to provide any medical records concerning that surgery as part of her “proof of loss.” The appellate court affirmed

²³ The Supreme Court held in *Cantrelle Fence and Supply Co., Inc. v. Allstate*, 515 So.2d 1074 (La.1987), that an obligation arising out of the penalty statute, La. R.S. 22:658, is separate and distinct from the obligation arising out of the contractual relationship under the insurance policy. This fact was further recognized by the supreme court in *Manuel v. La. Sheriff's Risk Management Fund*, 95-406, p. 6 (La.11/27/95), 664 So.2d 81, 84 when it stated that “[t]he duties that [La. R.S. 22:1220] does impose upon insurers are separate and distinct from the duties mentioned in the contract of insurance.”

Robin, p. 5-6, 844 So.2d at 46.

the trial court's rejection of the insured's statutory penalty claim, because the insured's failure to submit this documentation to the UM carrier made the "proof of loss" unsatisfactory.

- *An insurer's "bad faith" depends on the facts known to the insurer on the date of the refusal to pay.*

In *Sutton v. Oncale*, 99-967 (La. App. 5 Cir. 3/29/00) 765 So.2d 1072, the insured was injured in an automobile collision. After settling the tort claim against the other driver, the insured sought to recover R.S. 22:658 and R.S. 22:1220 statutory penalties from her UM insurer. Even though the trial court ultimately awarded the insured damages against the UM insurer, it concluded that the UM insurer had not violated either "bad faith" statute.

At the time the UM insurer refused to make any unconditional tender of UM benefits, there was very little supporting medical evidence. Additionally, the insured failed to follow through with the recommended medical treatment. Based on the facts that were known to the UM insurer when it refused to tender any benefits under the UM policy, the trial court's refusal to award statutory penalties against the UM insurer was affirmed by the Fourth Circuit.

- *As "penal" statutes, R.S. 22:658 and R.S. 22:1220 are strictly construed.*

In *Vaughn v. Franklin*, 00-0291 (La. App. 1 Cir. 3/28/01) 785 So.2d 79, writ denied 01-1551 (La. 10/5/01) 798 So.2d 969, an insurer that defended litigation against a common insured sought to recover those defense costs as well as R.S. 22:658 penalties from another insurer that breached its duty to defend the common insured. The claim for statutory penalties was rejected by the court:

Revised Statute 22:658 is a penal statute, and as such it must be strictly construed. *Sutton v. Oncale*, 99-967, p. 10 (La. App. 5th Cir.3/29/00), 765 So.2d 1072, 1078; *Maxie v. McCormick*, 95-1105, p. 6 (La. App. 1st Cir.2/23/96), 669 So.2d 562, 565-66. A strict construction of the statute does not allow for recovery of penalties and attorney fees by an insurer who is subrogated to the rights of an insured who sustained no damage. This statute was intended to protect insureds who were harmed by arbitrary, capricious, or bad faith actions of their insurers. While St. Paul acted arbitrarily in failing to provide a defense, the insureds were not harmed here. The co-insurer simply had to bear the costs of defense alone when those costs should have been shared by St. Paul.

Vaughn, at p. 15-16, 785 So.2d at 91.

A self-insured municipality is not an insurer. As R.S. 22:1220 and R.S. 22:658 are penal statutes that must be strictly construed, penalties may not be imposed under either statute based on the self-insured municipality's actions in handling claims for property damages to vehicle owners whose vehicles were damaged by paint overspray from a municipal building. *Rawls v. City of Bastrop*, 38,449 (La. App. 2 Cir. 5/12/04) 873 So.2d 934.

In *Bennett v. State Farm Ins. Co.*, 869 So.2d 321 (La. App. 3 Cir. 3/24/04), the court found that statutory penalties may not be imposed on an insurer for cancelling a policy. The court also found that the insurance company did not mislead the insured as to the applicable prescription period. With regard to the plaintiff's claim that the homeowner's insurer failed to properly adjust the claim, the court found that the insurer's actions were reasonable, as there was a legitimate factual dispute as to which of three different storms actually caused the damages.

La. R.S. 22:1220 is a penal statute and must be strictly construed, *Harrington*

v. Cato Corp., 32,055 (La. App. 2 Cir. 6/16/99), 740 So.2d 732, and the insurer has the right to litigate claims without being subjected to damages and penalties. *Darby v. Safeco Ins. Co.*, 545 So.2d 1022 (La.1989).

Bennett, at p. 10, 869 So.2d at 328.

Defense Obligations Owed by Insurer to Insured

1. Insurer's Duty to Investigate, Evaluate and Defend Claim

A. Reasonable Investigation/Loss Adjustment

An insurer may be liable for statutory penalties under R.S. 22:658 and R.S. 22:1220 if it fails to properly investigate a claim or to initiate a loss adjustment after it receives notice of the loss from the insured. This "duty to investigate" derives from the insurer's duties under both statutes to adjust claims.

Duty to Investigate - R.S. 22:658

With regard to property damage claims, R.S. 22:658A(3) provides:

Except in the case of catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim and of a claim for reasonable medical expenses within fourteen days after notification of loss by the claimant. In the case of catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim within thirty days after notification of loss by the claimant. Failure to comply with the provisions of this Paragraph shall subject the insurer to the penalties provided in R.S. 22:1220.

- In *Wallace v. State Farm Mut. Auto. Ins. Co.*, 36,099, p. 13, (La. App. 2 Cir. 6/14/02) 821 So.2d 704, 713, the court found that the R.S. 22:658A(3) requirement to adjust claims included a duty to investigate:

The clear intent of La. R.S. 22:658 is to impose upon the insurer not only a duty to pay claims timely but also a duty to conduct a reasonable investigation throughout the course of its denial of a claim. *See, Haynes v. Shumake, supra*. The trial court was not clearly wrong in concluding that State Farm failed to undertake such a reasonable investigation of Wallace's claim and that State Farm's failure to pay was arbitrary, capricious, and without probable cause. For this reason, we find no manifest error in the trial court's award of penalties and attorney fees under La. R.S. 22:658.

- R.S. 22:658(A)(3) requires that the insurer initiate loss adjustment of a claim within fourteen days after notification of the loss. To initiate loss adjustment the insurer must take “some substantive and affirmative step to accumulate the facts that are necessary to evaluate the claim.” *McClendon v. Economy Fire & Cas. Ins. Co.*, 98-1537 (La. App. 3 Cir. 4/7/99) 732 So.2d 727, 731.
- Merely opening a file does not comply with the R.S. 22:658A(3) requirement concerning “loss adjustment of a property damage claim” and subjects the insurer to R.S. 22:1220 penalties. *Hollier v. State Farm Mut. Auto. Ins. Co.*, 01-0592 (La. App. 3 Cir. 10/31/01) 799 So.2d 793, writ denied 01-3163 (La. 2/22/02) 810 So.2d 1135.

Duty to Investigate - R.S. 22:1220

R.S. 22:1220A provides in part: “. . . The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or both. . . .”

Even though a property damage insurer timely begins to adjust a claim, it may be liable for statutory penalties if the investigation of the claimed loss is insufficient. In *Clark v.*

McNabb, 04-0005 (La. App. 3 Cir. 5/19/04) 878 So.2d 677, the court found that the duty to investigate a claim falls within the R.S. 22:1220A duty to “adjust claims fairly and promptly.” While the insured’s auto insurer timely began an investigation, its failure to timely **complete** that investigation caused an award of statutory penalties to be affirmed.

Duty to Investigate - R.S. 22:657

In *Deutschmann v. Rosiere*, 02-2002 (La. App. 4 Cir. 4/9/03), 844 So.2d 1082, an insured filed an action against her health insurer, after the insurance company terminated her policy’s coverage based on alleged misrepresentations by the insured in her insurance application. The insured sought damages for wrongful cancellation of the policy, plus penalties and attorney’s fees (presumably pursuant to R.S. 22:657).

The evidence at trial established that the insurer did not inquire about the truthfulness of the insured’s statements in her application. The insurance company did not contact the insured’s doctors to verify whether the insured had made misrepresentations in the application. The court also found that had the insurer conducted a reasonable investigation, it would have known it had no valid basis for terminating the policy.

Affirming the trial court’s award of penalties and attorneys fees against the health insurer, the court stated:

An insurer has an affirmative duty to verify, through a reasonable investigation, whether a claim was actually excluded from coverage and when an insurer chooses to resist its contractual obligation based upon a supposed defense, which a reasonable investigation would have proved to be without merit, it acts at its peril and renders itself liable for statutory penalties and attorney's fees. *Savarino v. Blue Cross and Blue Shield of Louisiana, Inc.* 98-0635 (La. App.

1 Cir. 4/1/99), 730 So.2d 1083, 1090.
Deutschmann., at p. 5-6. 844 So.2d 1086.

Houston v. Blue Cross Blue Shield of Louisiana, 37,097 (La. App. 2 Cir. 4/9/03) 843 So.2d 542, *writ denied* 03-1342 (La. 9/19/03) 53 So.2d 641, was a R.S. 22:657 penalty claim arising out of a health insurance policy. The Court held that the insurer was liable for statutory penalties and attorneys fees for failing to investigate the claim, which lead to its untimely payment of benefits.

Once an insurer has notice that a claim exists, it has a duty to investigate that claim, *Crawford, supra*, [*Crawford v. Blue Cross Blue Shield of Louisiana*, 99-2503 (La. App. 1st Cir.11/3/00), 770 So.2d 507, *writ denied*, 00-3267 (La.2/16/01), 786 So.2d 98,] and the burden shifts to the insurer to show just and reasonable grounds for the delay. *Nerness v. Christian Fidelity Life Insurance Company*, 98-1827 (La. App. 3d Cir.4/21/99), 733 So.2d 146.

Houston, at p. 9, 843 So.2d 548.

R.S. 22:651 - Claims Adjustment Does Not Waive Insurer's Rights

Certain actions by an insurer in administering a claim do not constitute a waiver of the any policy provisions or defenses otherwise available to the insurer.²⁴ If the insured fails to institute a timely action against the insurer based on the fact that the insurer has opened a file and begun an investigation of the claim, the insurer has the right to assert a valid exception

²⁴ R.S. 22:651. Claim administration not waiver

None of the following acts by or on behalf of an insurer shall be deemed to constitute a waiver of any provision of a policy or of any defense of the insurer thereunder:

- (1) Acknowledgment of the receipt of notice of loss or claim under the policy.
- (2) Furnishing forms for reporting a loss or claim, for giving information relative thereto, or for making proof of loss, or receiving or acknowledging receipt of any such forms or proofs completed or incomplete.
- (3) Investigating any loss or claim under any policy or engaging in negotiations looking toward a possible settlement of any such loss or claim.

of prescription. See: *Maurice v. Prudential Insurance Co.*, 02-0993 (La. App. 4 Cir. 10/23/02), 831 So.2d 381 and *Katz v. Allstate Ins. Co.*, 04-1133, (La. App. 4 Cir. 2/2/05), 917 So.2d 443, writ denied, 05-0526 (La. 4/29/05) 901 So.2d 1069.

B. Insurer's Duty to Defend Claims Against its Insured

A liability insurer's duty to defend litigation against its insured and the scope of the insurer's coverage to the insured are separate and distinct issues. The duty to defend litigation exists, even when the insurance policy does not provide coverage for the claimed damages. *American Home Assurance Company v. Czarniecki*, 255 La. 251, 230 So.2d 253, 259 (1969); *Dennis v. Finish Line, Inc.*, 93-0638 (La. App. 1 Cir. 3/11/94), 636 So.2d 944, 946.

When an insurer breaches its duty to defend a claim against an insured, that insurer is liable to reimburse all of the reasonable attorneys' fees incurred by the insured to defend the main action. *Steptore v. Masco, supra*. The "arbitrary, capricious or without probable cause" breach of the duty to defend also triggers exposure for potential statutory penalties.

C. Insurer's Breach of its Duty to Defend its Insured Triggers Potential Statutory Penalties

Many courts hold that an insurer's arbitrary, capricious or without probable cause refusal to defend an insured violates R.S. 22:658A(1) and/or R.S. 22:1220B(5) and justifies the imposition of statutory penalties pursuant to R.S. 22:658B(1) and/or R.S. 22:1220C. See: *Shaffer v. Stewart Const. Co., Inc.*, 03-971 (La. App.5.Cir. 1/13/04) 865 So.2d 213; *Hampton v. Rubicon Chemicals, Inc.*, 90-0815, 90-0816 (La. App. 1 Cir. 3/28/91) 579 So.2d 458, 470;

Little v. Kalo Laboratories, Inc., 82-15103 (La. App. 2 Cir. 11/29/82) 424 So.2d 1065, writ denied 83-C-0297(La. 3/11/83) 430 So.2d 79; and *Parks Equipment Co. v. Travelers Ins. Co.*, 293 F.Supp. 1206 (E.D. La.1968).

Other reported decisions recognize that R.S. 22:658 authorizes the recovery of statutory penalties for the insurer's "arbitrary and capricious" breach of its duty to defend the insured. However, statutory penalties were not imposed because the plaintiffs did not prove that the insurer violated the "arbitrary and capricious" standard for imposition of penalties. See: *Sanders v. Wysocki*, 92-1190 (La. App. 4 Cir. 01/27/94) 631 So.2d 1330, 1335 , writ denied 94-0506 (La. 4/22/94) 637 So.2d 156; *Eymard v. C & W Well Servicing, Inc.*, 4791 (La. App. 4 Cir. 2/07/72) 258 So.2d 406, writ denied 52289 (La. 4/06/72) 261 La. 465, 259 So.2d 915 and *Saavedra v. Murphy Oil USA, Inc.*, 930 F.2d 1105 (5th Cir. 1991).

One First Circuit decision may be inconsistent with the other jurisprudence on this point. In *Vaughn v. Franklin*, 00-0291 (La. App. 1st Cir.3/28/01), 785 So.2d 79, writ denied, 01-1551 (La.10/5/01), 798 So.2d 969, the First Circuit reversed an award of statutory penalties against an insurer that breached its duty to defend its insured.

However, at least the rejection of the R.S. 22:658 statutory penalties was based on the unusual facts of that case. In *Vaughn*, one liability insurer defended the underlying claim against the common insured, then brought a subrogation claim against another insurer that breached its independent duty to defend the common insured. Although the defendant insurer was held responsible for contribution of 50% of the costs of defense, the First Circuit held that R.S. 22:658 penalties were inappropriate.

The Court noted that the common insured did not incur any actual defense costs in connection with the underlying action against it. According to the First Circuit, R.S. 22:658 penalties were inappropriate under these facts. *Vaughn*, at p. 14-15, 785 So.2d at 90-91.

The First Circuit also rejected the subrogated insurer's R.S. 22:1220 penalty claim. Relying on a broad interpretation of the Supreme Court's review of the legislative history of R.S. 22:1220 in *Theriot v. Midland Risk Insurance Company*, (on rehearing) 95-2895 (La.5/20/97), 694 So.2d 184, the First Circuit concluded that R.S. 22:1220B(5) and R.S. 22:1220C does not apply to an insurer's breach of its duty to defend the insured.

On rehearing, the *Vaughn* court reiterated its conclusion that R.S. 22:1220C does not apply to an insurer's breach of its contractual duty to defend the insured.

Finally, Farm Bureau disputes our interpretation of Revised Statute 22:1220, which we based on the Louisiana Supreme Court's statement in *Theriot v. Midland Risk Insurance Company*, 95-2895 (La.5/20/97), 694 So.2d 184, 191-192, that the purpose of the legislature in enacting that statute was to create a private cause of action for the knowing commission of certain egregious claims settlement practices. Farm Bureau contends our reliance on the supreme court's statements in *Theriot* is "clearly inappropriate"; it argues we should not look beyond the language of the statute itself. Despite Farm Bureau's obvious dissatisfaction with the supreme court's declaration of legislative intent, we cannot ignore it, and a consideration of that declaration of intent can lead to only one conclusion: that Revised Statute 22:1220 B(5) cannot apply to the breach of the duty to defend.

No other reported decision cites *Vaughn*'s conclusion that R.S. 22:1220B(5) is inapplicable to an insurer's breach of its duty to defend its insured. *Vaughn*'s conclusion that the scope of R.S. 22:1220B(5) is narrower than R.S. 22:658A(1) may be inconsistent with the Supreme Court's analysis of those provisions in *Calogero v. Safeway Insurance Company of*

Louisiana, supra, at p. 6-7, 753 So.2d at 174:

We have previously recognized the close relationship between the conduct prohibited in La. R.S. 22:658, subd. A(1) and the conduct prohibited in La. R.S. 22:1220, subd. B(5). *Theriot v. Midland Risk Ins. Co.*, 95-2895 (La.5/20/97), 694 So.2d 184, 192, n. 14. In fact, the conduct prohibited is virtually identical, i.e., failure to timely pay a claim after receiving satisfactory proof of loss when that failure to pay is arbitrary, capricious or without probable cause. The primary difference is that under La. R.S. 22:658, subd. A(1), the insurer must pay the claim within 30 days of receiving satisfactory proof of loss, rather than the longer 60-day period allowed under La. R.S. 22:1220, subd. B(5).

2. Duty to Report and Keep Insured Fully Advised

As noted earlier, *McGee v. Omni Ins. Co.*, 02-1012, p. 11 (La. App. 3 Cir. 3/5/03), 840 So.2d 1248, 1256, writs denied 03-1375 (La. 12/12/03), 860 So.2d 1149 and 03-1382 (La. 12/12/03) 860 So.2d 1149, held that an insurer's consistent failure to keep the insured advised of the status of the litigation and its failure to communicate the "pertinent facts" necessary for the insured to determine what was in her personal interest violated R.S. 22:1220B(1)'s prohibition of an insurer's "[m]isrepresenting pertinent facts or insurance policy provisions relating to any coverages at issue."

Long ago, the Supreme Court established a jurisprudential rule that an insurer's failure to keep its insured advised of the status of the case and of settlement offers constituted "bad faith" which subjected the insurer to the responsibility to pay an excess policy limits judgment. *Roberie v. Southern Farm Bureau Cas. Ins. Co.*, 48259 (La. 1/16/67), 250 La. 105, 194 So.2d 713.

See also *Maryland Cas. Co. v. Dixie Ins. Co.*, 92-0816 (La. App. 1 Cir. 3/28/93) 622

So.2d 698, writ denied 93-2382 (La. 12/10/93) 629 So.2d 1138. In that case, the insurer never advised the insured of settlement offers or of the effect a punitive damages exclusion in the policy may have had on any potential judgment. This failure to communicate exposed the insured to great potential for excess liability and precluded him from taking any decisive action in his own defense. Without citing any statutory provision, the court awarded attorney's fees to the insured against the insurer based on the insurer's "bad faith" failure to communicate.

In his dissenting opinion in *Smith v. Audubon Ins. Co.*, 95-2057 (La. 9/5/96) 679 So.2d 372, Chief Justice Calogero questioned the validity of *Maryland Casualty* and similar decisions. Justice Calogero noted that the only possible statutory basis for the award of attorney's fees in *Maryland Casualty* and similar pre-R.S. 22:1220 decisions was R.S. 22:658. He concluded that R.S. 22:658 does not apply to "failure to communicate with the insured" cases.

Despite that dissenting opinion, *Maryland Casualty* was cited with approval in *Lafauci v. Jenkins*, 01-2960, p. 13-14 (La. App. 1 Cir. 1/15/03) 844 So.2d 19, 29, writ denied 03-0498, (La. 4/25/03) 842 So.2d 403.

3. Settlement Obligations

In addition to the statutory "bad faith" provisions analyzed in this paper, the jurisprudence has established that insurance companies can be held responsible for damages sustained by their insureds resulting from "bad faith" conduct on the part of the insurer during

settlement negotiations. *Louis' Florist Shop of Lake Charles, Inc. v. United Fire & Cas. Co.*, 04-846, p.4 (La. App. 3 Cir. 11/10/04) 887 So.2d 696, 699.

In *Theriot v. Midland Risk Ins. Co.*, 95-2895 (La. 5/20/97) 694 So.2d 184, 192-193, the Supreme Court discussed the non-statutory “bad faith” cause of action that arises in settlement situations.

Finally, we note that the interpretation of La. R.S. 22:1220 advanced by the plaintiff would constitute a radical departure from accepted principles of insurance law. While this court has never defined the precise basis of the duties owed by an insurer to its insured, we have held that they are fiduciary in nature and include the duty to discharge policy obligations to the insured in good faith, to defend the insured against covered claims and to consider the interests of the insured as paramount in every settlement. *Pareti v. Sentry Indemnity Co.*, 536 So.2d 417, 423 (La.1988). It is generally agreed that an insurer's duties run primarily in favor of its insured as an outgrowth of duties that have their foundation in the contract between the parties. It is the relationship of the parties that gives rise to the implied covenant of good faith and fair dealing.

The jurisprudence establishes that “the insurer is the champion of its insured’s interests, that the interests of the insured are paramount to those of the insurer, and that the insurer may not gamble with the funds and resources of its policyholders.” *McGee v. Omni Ins. Co.*, 02-1012, p. 9 (La. App. 3 Cir. 3/5/03), 840 So.2d 1248, 1255, writ denied, 03-1375, 03-1382, (La.12/12/03), 860 So.2d 1149 (*quoting Cousins v. State Farm Mut. Auto. Ins. Co.*, 294 So.2d 272, 275 (La. App. 1 Cir.), *writ refused*, 296 So.2d 837 (La.1974)).

As a professional defender of lawsuits, the insurer is held to a higher standard than an unskilled practitioner. What may be neglect on the part of the latter may well constitute bad faith on the part of the insurer. *Keith v. Comco Insurance Company*, 21950 (La. App. 2 Cir.

½3/91) 574 So.2d 1270, 1277, writ denied, 577 So.2d 16 (La.1991).

Smith v. Audubon Ins. Co., 95-2057 (La.9/5/96) 679 So.2d 372 is the leading case on an insurer's obligations to its insured in settlement situations. Noting that it had never held that an insurer could be liable for paying an "excess judgment" rendered against its insured, the Supreme Court discussed the insurer's duties to its insured in settlement situations:

In the absence of bad faith, a liability insurer generally is free to settle or to litigate at its own discretion, without liability to its insured for a judgment in excess of the policy limits. William Shelby McKenzie & H. Alston Johnson, III, 15 *Louisiana Civil Law Treatise-Insurance Law and Practice* § 218 (1986). On the other hand, a liability insurer is the representative of the interests of its insured, and the insurer, when handling claims, must carefully consider not only its own self-interest, but also its insured's interest so as to protect the insured from exposure to excess liability. *Holtzclaw v. Falco, Inc.*, 355 So.2d 1279 (La.1978) (on rehearing). Thus, a liability insurer owes its insured the duty to act in good faith and to deal fairly in handling claims. *Id.*

.....

Thus, the determination of whether the insurer acted in bad faith turns on the facts and circumstances of each case. Of course, an insurer is not obliged to compromise litigation just because the claimant offers to settle a claim for serious injuries within the policy limits, and its failure to do so is not by itself proof of bad faith. The determination of good or bad faith in an insurer's deciding to proceed to trial involves the weighing of such factors, among others, as the probability of the insured's liability, the extent of the damages incurred by the claimant, the amount of the policy limits, the adequacy of the insurer's investigation, and the openness of communications between the insurer and the insured. [Footnote omitted]. Nevertheless, when an insurer has made a thorough investigation and the evidence developed in the investigation is such that reasonable minds could differ over the liability of the insured, the insurer has the right to choose to litigate the claim, unless other factors, such as a vast difference between the policy limits and the insured's total exposure, dictate a decision to settle the claim.

Smith, supra at pp. 7-11, 679 So.2d at 376-377

Whether an insurer's failure to settle a claim within its policy limits was in "bad faith"

is fact-intensive. In the absence of any evidence establishing that the insurer acted in “bad faith” in refusing to settle a claim within its policy limits, an “excess judgment” against the insurer constitutes reversible error. *Tunstall v. Stierwald*, 01-1765, p. 8-9 (La. 2/26/02), 809 So.2d 916, 922.

CONCLUSION

In the normal case, an insurance company’s denial of a first-party claim or its failure to settle a third-party claim against its insured within policy limits will not support a “bad faith” penalty claim against the insurer. However, if an insurance company’s violation of many of its statutory duties is unjustified, lacks a reasonable basis or is without probable cause or excuse, statutory penalties are appropriate and should be imposed by the courts.

