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Overview of Bad Faith Litigation in Missouri

I. INTRODUCTION

Under a standard liability agreement, an insurer owes its insured both a duty to defend and a duty to indemnify. When an insurer breaches either duty, the insured may have a cause of action for bad faith. Bad faith liability derives from a contract principle, the implied covenant of good faith and fair dealing. This implied covenant exists in insurance policies and governs virtually every duty and obligation the insurer owes to the insured. It requires the insurer to act in good faith when considering settlement offers during its defense of the insured.

Bad faith liability is a separate cause of action from failure to defend. If an insurer is obligated to provide a defense, but fails to do so, the insured has a cause of action for breach of contract. Where the insurer has an opportunity to settle a claim against its insured within the policy limits, but fails to do so, the insured may have an action for "bad faith" refusal to settle.

This Comment addresses these situations and details Missouri's approach to bad faith claims against insurers.

2. Id. ("The creation of an implied-in-law duty to deal fairly and in good faith has been justified on the grounds that (a) insurance policies are personal and are designed to protect individuals from the risks of accidental losses rather than to obtain commercial advantages, (b) there is a fiduciary relationship between the insurer and the insured, and (c) the uneven bargaining strength between the insured and insurer, together with the alleged 'adhesive' nature of insurance contracts requires that the insurer be held accountable for unreasonable practices." (citations omitted)).
6. Ganaway, 795 S.W.2d at 556.
II. LEGAL HISTORY OF THE INSURANCE BAD FAITH CLAIM

Over the past thirty years, "[w]hat was once an area of law which was fairly tidy and predictable [has become] the most dynamic and fluid area of American law." This change can most likely be attributed to the birth and evolution of bad faith litigation. Previously, insurance litigation issues focused on coverage interpretations and technical policy defenses. Although the courts treated insurance policies as contracts of adhesion and construed ambiguities against the drafters, damages awarded against insurers were confined to those available under the more limited rules governing contract breaches (i.e., breach of the insurance policy). However, with the recent evolution of bad faith claims, insurers now are faced with the possibility of damage awards far exceeding the policy limits. With the recovery caps removed, lawyers of the insured have been quick to capitalize on this burgeoning area of law.

The Missouri Supreme Court first addressed the issue of bad faith failure to settle in Zumwalt v. Utilities Insurance Co. In Zumwalt, the plaintiff sought to recover for an insurance company's bad faith and negligence in failing to settle a suit against the plaintiff within the limits of a liability policy. Although this was a case of first impression for the Missouri Supreme Court, the Eastern District Court of Appeals had previously decided this issue in McCombs v. Fidelity & Casualty Co. In McCombs, the court conducted an extensive review of the cases from other states and from the federal courts, and found that "[t]he courts are not in agreement in holding the insurer liable for negligence in refusing to settle, but there is no disagreement with respect to the insurer's liability where bad faith appears."

Following this logic, the supreme court, in Zumwalt, held that unless the insurer was guilty of fraud or bad faith in refusing to settle a claim within the

8. Id.
9. Id.
10. Id.
11. 228 S.W.2d 750, 753 (Mo. 1950).
12. Id. at 751.
13. Id. at 753.
14. 89 S.W.2d 114, 118 (Mo. Ct. App. 1936).
15. Id. at 121.
16. Id.
policy limits, the insurer would not be held liable for a judgment in excess of the policy limits.\textsuperscript{17} In rejecting the negligence standard, the court stated:

We have reviewed many authorities on the question and think the weight of authority is that where the insurer in a liability policy reserves the exclusive right to contest or settle any claim brought against the insured, and prohibits him from voluntarily assuming any liability or settling any claims without the insurer's consent, except at his own costs, and the provisions of the policy provide that the insurer may compromise or settle such a claim within the policy limits, no action will lie against the insurer for the amount of the judgment recovered against the insured in excess of the policy limits, \textit{unless the insured is guilty of fraud or bad faith in refusing to settle a claim} within the limits of the policy. There are cases that hold that the insured is entitled to recover upon proof that the insurer in refusing to settle a claim for damages was guilty of negligence. But this test is rejected in the better reason[ed] cases and we think rightly so.\textsuperscript{18}

\section*{III. First-Party Actions—Statutory Vexatious Refusal to Pay}

Like types of insurance, bad faith liability claims fall into two general categories—first-party claims and third-party claims. First-party insurance reimburses the insured for losses covered by the insurance policy. These losses can be incurred by either injury to the insured or damage to the insured’s property. Many states allow the insured to bring an actionable tort against his insurer for failing to reimburse the insured on a claim covered by the policy.\textsuperscript{19} In this scenario, the insured and injured party are the same person. This is defined as a first-party cause of action. A third-party cause of action, on the other hand, is one in which the insured or the insured’s assignee brings a cause of action against his insurer for a bad faith refusal to settle or defend his claim with the injured or aggrieved party.

\subsection*{A. Statutory Preemption}

Since it is preempted by statute, the tort of bad faith does not exist in Missouri with respect to first-party claims by an insured against an insurance company.\textsuperscript{20} Nevertheless, an insured can bring a cause of action for vexatious

\begin{itemize}
  \item \textsuperscript{17} Zumwalt v. Utilities Ins. Co., 228 S.W.2d 750, 753 (Mo. 1950).
  \item \textsuperscript{18} \textit{Id.} (citations omitted) (emphasis added).
  \item \textsuperscript{20} Koehrer v. American Motorists Ins. Co., 931 S.W.2d 898, 898 (Mo. Ct. App.)
\end{itemize}
refusal to pay under Missouri Revised Statutes Sections 375.296 and 375.420. These statutes provide the insured a right to assert a cause of action for damages, in addition to breach of contract damages, when the insurer has not complied with the terms of the applicable statute. The two statutes authorize damages for vexatious delay and provide that the court or jury may award vexatious damages and attorney's fees "in addition" to the amount due under the contract (Section 375.296) or the loss (Section 375.420). These two statutes differ in that Section 375.296 applies only to insurance companies not authorized to do business in Missouri.

Section 375.296, Additional Damages for Vexatious Refusal to Pay, states:

In any action, suit or other proceeding instituted against any insurance company, association or other insurer upon any contract of insurance issued or delivered in this state to a resident of this state, or to a corporation incorporated in or authorized to do business in this state, if the insurer has failed or refused for a period of thirty days after due demand therefor prior to the institution of the action, suit or proceeding, to make payment under and in accordance with the terms and provisions of the contract of insurance, and it shall appear from the evidence that the refusal was vexatious and without reasonable cause, the court or jury may, in addition to the amount due under the provisions of the contract of insurance and interest thereon, allow the plaintiff damages for vexatious refusal to pay and attorney's fees as provided in Section 375.420. Failure of an insurer to appear and defend any action, suit or other proceeding shall be deemed prima facie evidence that its failure to make payment was vexatious without reasonable cause.

Section 375.420, Vexatious Refusal to Pay Claim, Damages for, Exception, states:

In any action against any insurance company to recover the amount of any loss under a policy of automobile, fire, cyclone, lightning, life, health, accident, employers' liability, burglary, theft, embezzlement, fidelity, indemnity, marine, or other insurance except automobile liability insurance, if it appears from the evidence that such company has refused to pay such loss without reasonable cause or excuse, the court or jury may, in addition to the amount thereof and interest, allow the plaintiff damages not to exceed twenty percent of the first fifteen hundred dollars of the loss, and ten percent of the amount of the loss in excess of fifteen hundred dollars and a reasonable attorney's fee; and the court shall enter judgment for the aggregate sum found in the verdict.

1996).
B. Application of the Cause of Action

In order to sustain an award under these statutes, "[the] plaintiff must show that the insurer's refusal to pay the loss was willful and without reasonable cause, as the facts would appear to a reasonable and prudent person before trial."23 Furthermore, a plaintiff's verdict for the policy proceeds is not sufficient evidence in and of itself to warrant vexatious refusal penalties. "Vexatious refusal to pay is not to be deduced from the mere fact that upon trial the verdict is adverse to defendant. The word 'vexatiously', as used in the statute, Section 375.420 RSMo 1949, V.A.M.S., means without reasonable or probable cause or excuse."24

The "before trial" phrase in the above quotation "is significant because the fact that the trial judgment is adverse to the insurer's contention is not sufficient reason to impose the statutory penalty."25 Whether a refusal was vexatious must be determined by the facts as they reasonably appeared at the time the insurer refused to pay.26 "An insurance company's right to resist payment upon one of its policies cannot be determined by the facts as found by the jury, but must be determined by the facts as they reasonably appeared to it before the trial."27

The Missouri Supreme Court has provided guidance in determining whether evidence supports an award for vexatious refusal:

The existence of a litigable issue, either factual or legal, does not preclude a vexatious penalty where there is evidence the insurer's attitude was vexatious and recalcitrant. Direct and specific evidence to show vexatious refusal is not required[;] the jury may find vexatious [delay] upon a general survey and a consideration of the whole testimony and all the facts and circumstances in connection with the case.28

26. Id.; Katz 647 S.W.2d at 839.
The burden of proof is on the insured, and the vexatious refusal statutes, being penal in nature, must be strictly construed. "This strict construction requires that an award [under these statutes] be considered discretionary with the trial court." The court first decides whether there is sufficient evidence to support such a claim. If so, the court then addresses the issues of whether any penalty should be awarded by the court or jury, and if so, how much. These issues are purely discretionary matters for the judge.

C. Examples of Vexatious Refusals

The following are just a few of the many situations in which vexatious refusal penalties have been awarded:

1. Refusal to pay based on a suspicion that is unsupported by substantial facts.
2. Persistence in refusal to pay after insurer becomes aware that it has no meritorious defense.
3. Refusal to pay based on an inadequate investigation and a denial of liability without stating a ground for denial.
4. Refusal to pay founded not on what appeared to be the facts, but on a possibility that later investigation would develop facts justifying a refusal to pay, even if such investigation did develop such facts.

D. Possible Defenses

Missouri Revised Statutes Section 375.296 requires a showing that the insurance company's "refusal [to pay] was vexatious without reasonable cause." Likewise, Missouri Revised Statutes Section 375.420 requires a showing that the insurance company "has refused to pay such loss without reasonable cause or

30. Id.; Katz, 647 S.W.2d at 840.
31. Katz, 647 S.W.2d at 840.
32. Dewitt, 667 S.W.2d at 711 (citing Morris v. Reed, 510 S.W.2d 234, 242 (Mo. Ct. App. 1974)).
33. Id.
36. Allen, 753 S.W.2d at 620.
37. Buffalo Ins. Co. v. Bommarito, 42 F.2d 53, 57 (8th Cir. 1930) (cited as authority in Still v. Travelers Indem. Co., 374 S.W.2d 95 (Mo. 1963)).
excuse." Discussed below are defenses that courts have recognized and made available to insurance companies in vexatious refusal to pay cases.

1. Reasonable Cause or Excuse

As this is an element of the plaintiff's cause of action, it is technically not a defense. Nevertheless, an insurer can escape liability by showing that it had either a reasonable cause or excuse for its refusal to pay. The following examples are illustrative of this concept.

First, an insurer has the right to refuse payment and defend a suit so long as it has reasonable grounds to believe its defense is meritorious. However, if the insurer is aware that no such grounds exist and persists in its refusal to pay the policy, then it becomes subject to penalties for vexatious delay.

Also, an insurer may ask for a judicial determination of its liability without becoming subject to a vexatious delay penalty for good faith contest of the claim. An honest difference of opinion as to the extent of liability is allowed. An insurer will not be penalized for insisting, in good faith, on a judicial determination of open questions of fact or law determinative of the issue of liability. Disputes over the proximate cause of an insured's death and the appropriate statute of limitations to apply represent two such questions.

Finally, in some situations, the law is unsettled, and, thus, the insurer has no way of ascertaining the extent of liability. For example, in Hopkins v.

39. State ex rel. John Hancock Mut. Life Ins. Co. v. Hughes, 152 S.W.2d 132, 134 (Mo. 1941) (quoting State ex rel. Confidential Life Ins. Co. v. Allen, 262 S.W.2d 43, 45 (Mo. 1924)).
40. Id.; See also Morris v. J.C. Penney Life Ins. Co., 895 S.W.2d 73, 78 (Mo. Ct. App. 1995).
42. Id.
44. Young v. New York Life Ins. Co., 228 S.W.2d 670 (Mo. 1950) (holding defendant's refusal to pay not vexatious when the plaintiff claimed life insurance benefits under a double indemnity clause for accidental death, and the issue of whether the proximate cause of death was disease or accident presented a question of fact upon which there could be an honest difference of opinion).
45. Crenshaw v. Great Cent. Ins. Co., 482 F.2d 1255 (8th Cir. 1973) (holding that under Missouri law, statute of limitations issue raised by defendant insurer was an open question of law such that refusal to pay could not, to a legal certainty, be considered vexatious).
American Economy Insurance Co., an insurance company refused to allow an insured to stack underinsured motorist coverage. The insured brought an action for vexatious refusal to pay. However, because the law was unclear on whether an insured could stack underinsured coverage, the court did not impose a penalty on the insurance company.

2. Contract Defenses

An insured's claim for vexatious refusal to pay is dependent upon what is contained in the insurance policy. Before any vexatious refusal claim can succeed, coverage must first be found to exist under the policy. Since the insurance policy is a contract between the insurer and the insured, an insurer may be able to escape liability for its refusal to pay based on defenses applicable to general contract law.

When the language in the policy is ambiguous, courts may resort to well-established contract principles to ascertain its meaning. The insurance company may be able to convince the court of a favorable construction by evidence of the parties' acts, conduct, or declarations indicating a certain understanding:

It is a well-established rule of law that the construction placed upon a contract by the parties as evidenced by acts, conduct, or declarations indicating a mutual intent and understanding will be adopted by the courts where the language of the contract is ambiguous, or there is reasonable doubt as to its meaning, but not where it is plain and unambiguous.

However, where this evidence is lacking, the court may treat the insurance policy as a contract of adhesion and construe any ambiguities against the drafters.

Also, misrepresentations by an insured may be an effective way for the insurer to avoid the policy. Without a valid policy, the insured has no basis for a vexatious refusal to pay claim:

The rule in this state, as we understand it, is that where material representations made in an application for a policy of life insurance are

46. 896 S.W.2d 933 (Mo. Ct. App. 1995).
47. Id.
48. Id.
49. Id. at 945.
51. Id.
52. Id. (citing Scotten v. Metropolitan Life Ins. Co., 81 S.W.2d 313, 315 (Mo. 1935)).
warranted to be true, or the policy is conditioned upon the truth of the representations, or provides that the falsity of the representations shall avoid the policy, then the representations, if in fact untrue, will avoid the policy, though the representations were innocently made. This is so because such is the contract. The insurer is entitled to stand on the contract as written, and the innocence of the insured in making the representations is a matter of no concern. But where there is no such warranty or provision in the policy, a misrepresentation, in order to avoid the policy must have been fraudulently made. This is the rule applicable to contracts generally, and we see no reason why an exception should be made with respect to insurance contracts.\textsuperscript{53}

An insurance company will be bound by its soliciting agent's knowledge of false or incorrect statements made in an insurance application.\textsuperscript{54} An exception to this rule exists when the agent and the applicant act in fraudulent collusion in connection with the application.\textsuperscript{55} However, this rule of constructive knowledge should not be applied in connection with inflicting penalties for vexatious delay.\textsuperscript{56}

In addition to the contract and misrepresentation defenses, a statute of limitations defense may be available to the insurer.\textsuperscript{57}

3. Federal Preemption

If an insurance plan satisfies the statutory requirements, a claim against the insurance company under the Missouri vexatious refusal to pay statute is preempted by the Employment Retirement Income Security Act (ERISA).\textsuperscript{58} To be governed by ERISA, the insurance plan must be: (1) a plan, fund or program;

\textsuperscript{53} Dixon v. Business Men's Ins. Co. of Am., 285 S.W.2d 619, 625 (Mo. 1955) (quoting Houston v. Metropolitan Life Ins. Co., 97 S.W.2d 856, 860 (Mo. Ct. App. 1936)).

\textsuperscript{54} State ex rel. John Hancock Mut. Life Ins. Co. v. Hughes, 152 S.W.2d 132, 134 (Mo. 1941).

\textsuperscript{55} Id.

\textsuperscript{56} Id. The supreme court, recognizing that it was matter of common routine in the insurance business, took judicial notice that the duty of the soliciting agent was to secure applications and not be involved with the payment or refusal of claims. Therefore, it might be possible to impute this constructive knowledge to the company where the agent is involved somehow with the payment or refusal of claims. Id.


(2) established or maintained; (3) by an employer or by an employee organization, or both; (4) for the purpose of providing medical, surgical, or hospital care, sickness, accident, disability, death, unemployment or vacation benefits, apprenticeship or other training programs, day care centers, scholarship funds, prepaid legal services or severance benefits; (5) to the participants or their beneficiaries. 59

E. Assignment

The general rule is that "an assignment made by the insured after the event has occurred on which liability under an insurance policy is predicated does not violate a policy provision prohibiting assignment of the policy or its benefits." 60 This principal has been extended to include the awards deriving from a vexatious refusal to pay claim. 61

Although decided under an older and slightly different statutory version, several Missouri cases held that penalties and attorney's fees awarded pursuant to the vexatious refusal to pay statute were assignable. 62 Even though the statutory language has changed slightly, these cases retain their precedential value. "During the course of revisions, however, the principal language of the statute has remained the same, and the particular phraseology which formed the basis for the court's ruling in Lehman [v. Hartford Fire Insurance Co.] 63 still remains intact in the current statute." 64 Relying on this, a federal district court, interpreting Missouri law, held that the attorney's fees and penalty awarded under the statute requiring insurer to pay for unwarranted and vexatious delays were assignable. 65


60. Magers v. National Life & Accident Ins. Co., 329 S.W.2d 752, 756 (Mo. 1959) (suggesting that there may be situations wherein the right of the beneficiary to assign the proceeds of a life policy may be properly limited or prohibited altogether).


62. Id. at 1108 (citing Still v. Travelers Indem. Co., 374 S.W.2d 95 (Mo. 1963) (holding that an assignment of claims under fire policies could include a claim for penalties for vexatious delay in payments due under the policy); Bergeson v. General Ins. Co. of Am., 148 S.W.2d 812, 820 (Mo. Ct. App. 1941) (holding that claims for attorney's fees and the statutory penalty requiring insured[r] to pay for unwarranted and vexatious delays were assignable)).

63. 167 S.W.2d at 1047, 1050 (Mo. Ct. App 1914).

64. Citicorp, 672 F. Supp. at 1108.

65. Id. at 1109 ("U]nder Missouri law, a statutory claim for punitive damages and attorney's fees is clearly assignable.").
F. Damages

Both vexatious delay statutes permit the court or jury to award damages and/or attorney's fees in addition to any amount due under the contract (Section 375.296) or the loss (Section 375.420). However, only Section 375.420 dictates how the vexatious delay damages are to be calculated.

1. Statutorily Calculated Damages

A cause of action based on the allegation that an insurance company negligently denied payment to an insured following the filing of a proof of loss is preempted by Section 375.420, the vexatious refusal to pay statute. The vexatious refusal to pay statute provides in pertinent part:

[The court or jury may, in addition to the amount thereof and interest, allow the plaintiff damages not to exceed twenty percent of the first fifteen hundred dollars of the loss, and ten percent of the amount of the loss in excess of fifteen hundred dollars and a reasonable attorney's fee; and the court shall enter judgment for the aggregate sum found in the verdict.]

2. Attorney's Fees

Section 375.420 allows a plaintiff to recover the value of any attorney's fees provided the fees are reasonable. This award is allowable despite the denial of vexatious damages. "To recover attorney fees authorized by 375.296 and 375.420, the claim must be supported by appropriate pleadings, and the allegations must be sustained by proof." Without evidence in the record showing the reasonable value of the attorney's services, the issue of attorney's fees under the statute should not be submitted.

67. MO. REV. STAT. § 375.296 (1994) provides: "[T]he court or jury may . . . allow the plaintiff damages for vexatious refusal to pay and attorney's fees as provided in section 375.420."
71. Id. (citing Fay, 187 S.W. at 865; Williams v. United Ins. Co. of Am., 618 S.W.2d 229, 233 (Mo. Ct. App. 1981); City of Aururo v. Firemen's Fund Ins. Co., 165 S.W. 357, 362 (Mo. Ct. App. 1914) (the statute requires that the fee be reasonable)).
In *DeWitt v. American Family Mutual Insurance Co.*\(^{72}\), the Missouri Supreme Court held that an award of attorney's fees without an award of vexatious damages is not improper:

Numerous cases have allowed the imposition of attorney fees without an additional award of damages.\(^{73}\) We note that "[t]his statute on its face is permissive not mandatory. The question of whether any penalty will be awarded, and if so, how much, is a matter of pure discretion."\(^{74}\) We conclude that the award of attorneys fees alone is not improper.\(^{75}\)

3. Punitive Damages

Punitive damages, which cannot constitute an independent cause of action,\(^{76}\) must be incident to another cause of action.\(^{77}\) Punitive damages are within the discretion of the jury when the necessary elements such as malice and fraud are present.\(^{78}\) They cannot be awarded unless there is a cause of action for compensatory damages\(^{79}\) and the party bringing such an action actually recovers at least nominal compensatory damages.\(^{80}\) An award of actual damages is a prerequisite to the recovery of punitive damages.\(^{81}\) However, when a case is independent of punitive damages, but nevertheless provides sufficient evidence of circumstances justifying punitive damages, the plaintiff has a right to, and the court is required to, submit the issue of punitive damages to the jury.\(^{82}\)

With these general rules, one would think that punitive damages would be recoverable in a vexatious refusal claim. In a literal sense they are, because the courts treat the statutory damages for vexatious refusal to pay not as penalties but as punitive damages.\(^{83}\) "The Supreme Court of Missouri has declared that such

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72. 667 S.W.2d 700, 711 (Mo. 1984).
73. Id. (citing Duckworth v. United States Fidelity & Guar. Co., 452 S.W.2d 280, 287 (Mo. Ct. App. 1970) (award reversed on appeal because of a finding of no vexatious refusal); Willis v. American Nat'l Life Ins. Co., 287 S.W.2d 98, 100 (Mo. Ct. App. 1956); Evans v. Great Northern Life Ins. Co., 167 S.W.2d 118, 125 (Mo. Ct. App. 1942)).
74. Id. (quoting Morris v. Reed, 510 S.W.2d 234, 242 (Mo. Ct. App. 1974)).
75. *DeWitt*, 667 S.W.2d at 711.
77. Id.
78. Id.
79. *Id.* at 579.
80. *Id.* (citing Hoagland v. Forest Park Highlands Amusement Co., 70 S.W. 878 (Mo. 1902)).
82. Landum v. Livingston, 394 S.W.2d 573, 579 (Mo. Ct. App. 1965) (citing *Spitzengel v. Greenlease Motor Car Co.*, 136 S.W.2d 100 (Mo. Ct. App. 1940)).
83. State *ex rel.* United States Fidelity & Guar. Co. v. Walsh, 540 S.W.2d 137, 141
[vexatious] damages and attorney fees are . . . punitive in character.\textsuperscript{84} However, the measure of damages recoverable in vexatious refusal to pay actions is limited to the amount of loss, interest, statutory penalty of specified percentage of loss, and reasonable attorney's fees.\textsuperscript{85} Therefore, plaintiff's punitive damage award or statutory penalty is limited to the amount allowed by the vexatious refusal to pay statute.\textsuperscript{86}

4. Interest

Section 375.420 states in pertinent part: "[T]he court or jury may, in addition to the amount thereof and interest, allow the plaintiff damages . . . ." Thus, in a claim for vexatious refusal, an insured may collect interest on the amount withheld. This interest is not conditioned on a finding of vexatiousness.

In Catron v. Columbia Mutual Insurance Co.,\textsuperscript{87} the Missouri Supreme Court held that the insureds were entitled to prejudgment interest, even though the damages awarded were less than those sought. In reaching its holding, the court relied on "[t]he often stated general rule . . . that interest is not recoverable on an unliquidated demand,\textsuperscript{88} and the various interpretations and exceptions to this general rule.\textsuperscript{89} Vexatious refusal claims constitute one such instance. "Missouri courts have allowed prejudgment interest for insurance claims where the parties did not agree to the amount due under the policy."\textsuperscript{90} By allowing interest, courts rely on the traditional purpose interest serves of compensating for

\begin{itemize}
\item[(Mo. Ct. App. 1976)] (noting Jones v. Prudential Ins. Co. of Am., 155 S.W. 1106, 1110 (Mo. Ct. App. 1913)).
\item 84. American Sur. Co. v. Franciscus, 127 F.2d 810, 817 (8th Cir. 1942) (citing Jones, 155 S.W. at 1110).
\item 86. Id.
\item 87. 723 S.W.2d 5 (Mo. 1987).
\item 88. Id. at 6 (citing Fohn v. Title Ins. Corp., 529 S.W.2d 1, 5 (Mo. 1975); Laughlin v. Boatmen's Nat'l Bank, 189 S.W.2d 974, 979 (Mo. 1945)).
\item 89. Id. (citing Burger v. Wood, 446 S.W.2d 436, 443-44 (Mo. Ct. App. 1969)).
\item 90. Id. at 7 (citing Hawkinson Tread Tire Serv. Co. v. Indiana Lumbermen's Mut. Ins. Co., 245 S.W.2d 24 (Mo. 1951) (the court characterized the parties' differing estimates of loss as a disagreement regarding the extent of the insurer's liability and allowed an award for prejudgment interest); DeLisle v. Cape Mut. Ins. Co., 675 S.W.2d 97 (Mo. Ct. App. 1984) (the court awarded prejudgment interest on a disputed insurance claim where the dispute was created by the conflicting damage estimates provided by the parties' experts); Boenzle v. United States Fidelity & Guar. Co., 258 S.W.2d 938 (Mo. Ct. App. 1953) (the court awarded prejudgment interest, although the insured had demanded a much greater sum than was actually owed him, finding that the amount had become due and payable thirty days after the insured filed the proof of loss)).
\end{itemize}
the use, or the loss of use, of money to which a person is entitled. 91 Further, the Catron court may have considered equitable principles of fairness and justice when awarding prejudgment interest. 92

Another court reached the same result by concluding that an amount due does not become unliquidated because the defendant contests its liability under the policy. 93 "A liquidated claim is one that is readily ascertainable by reference to recognized standards. The fact that defendant contests its liability under the policy does not make the amount due unliquidated." 94 Therefore, the general rule is applicable to the liquidated claim, and, in this case, pre-judgment interest was properly assessed.

Furthermore, interest can be awarded to a party regardless of whether vexatious damages or attorney's fees are awarded. "Section 375.420 RSMo 1986 authorizes damages and reasonable attorney's fees for vexatious refusal to pay. Those awards are in addition to the amount of the loss and interest. The interest award therefore is not conditioned upon vexatious refusal to pay. 95

5. When Insured Seeks More Than the Vexatious Refusal Statute Allows

In general, there can be no vexatious refusal when a plaintiff seeks a recovery for more than he is entitled, 96 "at least when the admitted portion is insignificant in comparison with the total amount which is wrongfully claimed." 97 However, an exception exists when there is a dispute over both the amount due and the liability under the policy and the plaintiff recovers less than

91. Id. (citing Laughlin v. Nat'l Bank, 189 S.W.2d 974, 979 (Mo. 1945)).  
92. Id. (citing St. Louis Housing Auth. v. Magafas, 324 S.W.2d 697, 700 (Mo. 1959); General Ins. Co. of Am. v. Hercules Constr. Co., 385 F.2d 13, 25 (8th Cir. 1967)).  
94. Id. (citing Schmidt v. Morival Farms, 240 S.W.2d 952, 961 (Mo. 1951); Twin River Constr. Co. v. Public Water Dist., 653 S.W.2d 682, 695 (Mo. Ct. App. 1983)).  
97. Irelan, 379 S.W.2d at 821 (citing Boenzle v. United States Fidelity & Guar. Co., 258 S.W.2d 938 (Mo. Ct. App. 1953); Brown v. Mutual Life Ins. Co., 140 S.W.2d 91 (Mo. Ct. App. 1940)).
the amount for which he sued. In this situation, a vexatious recovery is not precluded.

G. Hearsay Evidence Issues

A plaintiff is not required to present direct and specific evidence in proving his vexatious refusal claim. "Direct and specific evidence to show vexatious refusal is not required, the jury may find vexatious delay upon a general survey and a consideration of the whole testimony and all the facts and circumstances in connection with the case." Given the nature of this first-party cause of action, hearsay evidence is often admissible and necessary for the plaintiff to prove his case.

In Goodman v. State Farm Insurance Co., the court admitted hearsay evidence involving the testimony of an insurance company's investigator concerning statements made to him by insured's neighbors which linked the insured to the fire in question. This testimony was properly admitted because it was not offered for its truth, but was offered to establish the information in the possession of the defendant when it denied plaintiffs' claim. Thus, it was relevant to the plaintiffs' allegations of vexatious refusal to pay injected into the lawsuit by plaintiffs' petition. But if the plaintiffs so requested, they were entitled to an instruction limiting the extent to which, and the purpose for which, the jury could consider this evidence.

In Scott v. Missouri Insurance Co., the court admitted hearsay evidence involving a report prepared for an insurance company during an investigation concerning death benefits. The issue before the jury was "whether the facts and evidence in defendant's possession would have caused a reasonable person in good faith to believe that there was no liability to plaintiff on the [Insurance]

98. Berry, 621 S.W.2d at 953 (citing Wood v. General Ins. Co. of Am., 77 S.W.2d 167, 169 (Mo. Ct. App. 1934); Glover v. Liverpool & London & Globe Ins. Co., 186 S.W. 583, 584 (Mo. Ct. App. 1916)).
99. Id.
100. Id. at 953 (citing Evans v. Great Northern Life Ins. Co., 167 S.W.2d 118, 125 (1942)).
101. Id.
102. 710 S.W.2d 423 (Mo. Ct. App. 1986).
103. Id. at 424 (citing Scott v. Missouri Ins. Co., 233 S.W.2d 660 (Mo. 1950); Toler v. Atlanta Life Ins. Co., 248 S.W.2d 53 (Mo.Ct. App. 1952)).
104. Goodman, 710 S.W.2d at 423.
105. Id.
106. 233 S.W.2d 660, 664 (Mo. 1950).
107. Id.
The court, pointing out that many hearsay exceptions exist, determined that a report, prepared for the insurance company and relied upon in reaching its conclusion that it was not liable, was admissible for the limited purpose of showing the defendant insurance company acted reasonably in denying plaintiff's claim.\textsuperscript{109}

The report, though hearsay, was relevant and admissible on the issue of whether there was consideration for the release, that is, whether or not there was a genuine good faith dispute as to liability and whether the facts and evidence in defendant's possession would have caused a reasonable person in good faith to believe that there was no liability to plaintiff on the policy.\textsuperscript{110}

While the report was not competent for the purpose of proving the truth of the statements set out therein, the report itself and defendant's knowledge of its content formed a necessary link in a chain of circumstantial evidence tending to show that defendant had made a reasonable investigation and had ascertained facts which would cause a reasonable person in good faith to believe that the insured had heart trouble when the policy was issued; that such heart trouble caused or contributed to her death; and that defendant was not liable to plaintiff.\textsuperscript{111}

Thus, the report should have been admitted with a proper limiting instruction.
The court stated:

[W]here evidence is admissible for one purpose or one issue but would be improper for other purposes and upon other issues in the case, it should be received. The opponent then has a right to an instruction if he should request it limiting the extent to which and the purpose for which the jury may consider such evidence.\textsuperscript{112}

IV. THIRD-PARTY ACTIONS

In a third-party action, the insured or the insured's assignee asserts a cause of action against his insurer for damages resulting from the insurer's improper handling of a third party's claim against the insured. In the first-party action, on

\textsuperscript{108} Id.

\textsuperscript{109} Id.

\textsuperscript{110} Id. at 665 (citing Foster v. Aetna Life Ins. Co., 176 S.W.2d 482, 485 (Mo. 1943); O'Leary v. Scullin Steel Co., 260 S.W. 55, 61 (Mo. 1924); Looff v. Kansas City Rys. Co., 246 S.W. 578, 580 (Mo. 1922); Henry v. First Nat'l Bank, 115 S.W.2d 121, 133 (Mo. Ct. App. 1938)).

\textsuperscript{111} Id.

\textsuperscript{112} Scott v. Missouri Ins. Co., 233 S.W.2d 660, 665 (Mo. 1950) (citing State ex rel. Kansas City Pub. Serv. Comm'n v. Shain, 134 S.W.2d 58, 61 (Mo. 1939)).
the other hand, the insured asserts a claim against his insurer for not reimbursing him on a claim covered by the policy. Third-party actions arise in the context of liability insurance. Only liability insurance is truly third-party insurance because the interests protected by the policy are ultimately those of strangers to the contract who are injured by the insured's conduct.113

Insurance policies normally contain provisions obligating the insurer to defend and indemnify claims against the insured. The insurer breaches the contract if it fails to fulfill these obligations. For example, where an insurer who is obligated to provide a defense fails to do so, the insured has a cause of action for breach of contract.114

Additionally, most courts, including those of Missouri, recognize and impose upon the insurer the duty of acting in "good faith" when handling claims against the insured.115 This duty derives from a contract principle, the implied covenant of good faith and fair dealing. This implied covenant exists in insurance policies116 and governs virtually every duty and obligation the insurer owes to the insured.117 It requires the insurer to act in good faith when considering settlement offers during its defense of the insured.118 Where the insurer has an opportunity to settle a claim against its insured within the policy limits and fails to do so, the insured may have an action for bad faith refusal to settle.119

This Comment will address three situations in which a third-party action may arise. The first situation transpires when an insurer acts in bad faith in failing to settle a claim against its insured within the policy limits. The second situation occurs when an insurer, in bad faith, fails to defend a claim against its insured. The third situation is a combination of the two previous situations. It occurs when an insurer acts in bad faith in failing to settle and failing to defend a claim against the insured. These third-party actions for bad faith refusal to settle and/or defend are actions in tort, not contract.120

115. Id. at 927.
119. Id. at 556.
120. Zumwalt v. Utilities Ins. Co., 228 S.W.2d 750, 753-54 (Mo. 1950).
V. BAD FAITH FAILURE TO SETTLE FOR INSURED-TORTFEASOR

A. Elements

Most bad faith claims arise within the context of a third-party tort claim against the insured. Typically the claim arises because the insurance company did not settle a claim when it had an opportunity and demand to do so. This failure is often the consequence of the conflict of interest between the insurer and its insured.

For example, suppose P and D are involved in an auto accident in which D is at fault. If D is insured for $50,000 and P offers to settle for $50,000, D's insurer likely will not settle. The insurer will litigate since it stands to lose no more by a verdict in excess of $50,000. However, since D will be personally liable for this excess, D desires to settle. To provide insureds such as D protection from this conflict of insurers' interests, the courts have recognized the bad faith refusal to settle cause of action.

In *Dyer v. General American Life Insurance Co.*, the court set forth the elements of this cause of action as follows:

1. The liability insurer has assumed control over negotiations, settlement, and legal proceedings brought against the insured;
2. The insured has demanded that the insurer settle the claim brought against the insured;
3. The insurer refuses to settle the claim within the liability limits of the policy; and
4. In so refusing, the insurer acts in bad faith, rather than negligently.

B. Factors to Consider

Determining whether bad faith exists is a question for the trier of fact that must be decided with reference to the totality of the circumstances. In order to recover, there must be a showing of bad faith, not just negligence. Facts that may indicate bad faith by the insurer include:

1. Attempts to escape obligations under the policy by an intentional disregard of the financial interests of the insured;
2. Attempts to force the insured to contribute money to a settlement within the limits of the policy;

121. 541 S.W.2d 702, 704 (Mo. Ct. App. 1976).
122. *Ganaway*, 795 S.W.2d at 562.
123. *Zumwalt*, 228 S.W.2d at 753.
3. A preference to gamble on escaping all liability by a favorable verdict rather than accepting a reasonable settlement;
4. Failing to foresee a probable excess verdict;
5. Following advice not to settle or ignoring settlement advice;
6. Failing to advise the insured about the extent of policy coverage;
7. Failing to disclose policy limits to the claimant;
8. Improperly investigating or evaluating a claim;
9. Failing to advise the insured about the potential for an excess judgment;
10. Failing to advise the insured about the existence of settlement offers;
11. Failing to take preventative action allowing the insured to be held harmless; and
12. Taking a hard-line settlement approach.¹²⁴

C. Assignability

In Missouri, the general rule is that causes of action, if they survive, are assignable to the personal representative.¹²⁵ However, an exception to this general rule exists: although personal injury actions survive,¹²⁶ they are not assignable.¹²⁷

Under this scheme, in Quick v. National Auto Credit, the Eighth Circuit Court of Appeals held that a bad faith cause of action was not assignable.¹²⁸ To reach this result, the Eighth Circuit had to distinguish Ganaway v. Shelter Mutual Insurance Co.¹²⁹ In Ganaway, the Missouri Court of Appeals upheld a bankruptcy trustee's assignment of the debtor's bad faith claim.¹³⁰ The Ganaway court reasoned that, under the 1978 Bankruptcy Act, all legal and equitable interests of the debtor, including causes of action, became a part of the

¹²⁴ Id. at 750 (Mo. 1950); See DALE L. BECKERMAN, BAD FAITH LITIGATION IN MISSOURI 40 (1995).
¹²⁷ Beall, 76 S.W.2d at 1099; Bozarth, 778 S.W.2d at 2 n.1. See also Eastern Atl. Transp. & Mechanical Eng'g, Inc. v. Dingman, 727 S.W.2d 418, 423 (Mo. Ct. App. 1987) (holding that a tort claim is assignable, to the extent that it provides the basis for an award of exemplary damages, in an action for breach of contract).
¹²⁹ 795 S.W.2d 554 (Mo. Ct. App. 1990).
¹³⁰ Id.
bankruptcy estate. The court then stated that "the general law" allows a bad faith claim to be assigned to a judgment creditor either by the insured or by a bankruptcy trustee.

Recognizing a conflict between Ganaway and other Missouri precedent and noting that "Ganaway runs upstream from clearly established Missouri law," the Eighth Circuit preceded to distinguish Ganaway from Quick. The Eighth Circuit noted that, in Missouri, a claim for damages for personal tort is nonassignable, unless otherwise provided by statute. Since Ganaway involved a statutory exception to nonassignability, it was easily distinguished. Accordingly, the Eighth Circuit held that the bad faith cause of action was nonassignable.

D. Defenses

The defenses that were discussed in the context of first-party actions also are applicable in the third-party context. In addition, the following defenses apply to the third-party bad faith failure to settle action.

It is now well settled in Missouri that, where the insurer assumes the defense of a suit against its insured and acts in bad faith in refusing to settle the claim within its policy limits when it has a chance to do so, it may be liable over and above its policy limits. Conversely, where the company in good faith believes there is a valid defense to the claim, even though the defense proves unsuccessful and results in a judgment against the insured above the policy limits, the company is not liable, because of such honest mistake, beyond the limits of its policy. Good faith requires an insurer to settle within the policy limits as its honest judgment and discretion dictates.

131. Id. at 564.
132. Id. at 565 (citing V. Woerner, Annotation, Assignability of Insured's Right to Recover Over Against Liability Insurer for Rejection of Settlement Offer, 12 A.L.R.3d 1158 (1967)).
133. Quick, 65 F.3d at 746.
134. Id.
135. Id.
137. Id. (referring to Frank B. Connet Lumber Co. v. New Amsterdam Cas. Co., 236 F.2d 117 (8th Cir. 1956)).
138. Id.
Liability insurance policies often contain valid and enforceable conditions requiring the insured to cooperate.139 If an insured does not perform the conditions of the liability contract, then the insurer may be released from liability under the policy for the particular casualty in question. For example, an insured's failure to cooperate releases the insurer from liability, provided that the insurer has not acted fraudulently, in bad faith, or collusively.140 To establish such a breach of a condition to cooperate, the insured's failure to cooperate must be unexcused and substantially material.141 Further, an insurer may have to show prejudice. However, this showing of prejudice does not require that the insurer sustained a pecuniary loss or that the jury verdict would have been different. It requires only that the insurer show that it was prejudiced in the preparation and defense of a case.142 Both willfully misinforming the insurer as to facts essential to the preparation of a defense and collusion with a plaintiff to misrepresent material facts are situations which can constitute a failure of insured to cooperate.143

Also, if the claimant does not offer to settle, or is unwilling to settle, within the policy limits, the insurer cannot be guilty of bad faith failure to settle.144 An insurer must have the opportunity to settle within the policy limits before bad faith failure to settle can occur.145

Furthermore, even though actions based on insurance contracts are governed by a ten-year statute of limitations,146 Missouri courts treat bad faith failure to settle as an action in tort, not in contract.147 Thus, bad faith actions are governed by the five-year statute of limitations applicable to torts.148 The statute of limitations does not begin to run on a bad faith cause of action until the appellate process is complete and a final judgment is entered.149 However, parties to insurance contracts are free to include mutually agreed-upon limitations and restrictions when such limitations and restrictions do not conflict with statute or public policy.150

139. Quisenberry v. Kartsonis, 297 S.W.2d 450, 453 (Mo. 1956).
140. Id.
141. Id.
142. Id. at 454.
147. Zumwalt v. Utilities Ins. Co., 228 S.W.2d 750, 756 (Mo. 1950).
148. Mo. REV. STAT. § 516.120.4 (1994).
Reliance on the advice of competent counsel also may provide a defense against bad faith allegations.151 This defense is offered to prove that the insurer acted reasonably and with proper cause.152 If, however, the insurer knew or had reason to know that the advice was incorrect, this defense is not available.153 The court is permitted to explore whether the insurer's reliance was reasonable under the circumstances.154 The assertion of this defense constitutes a limited waiver of the attorney-client privilege between the insurer and its attorney.155 The insured is entitled to discovery relating to this advice provided by counsel to the insurer.156 Also, if the statutory requirements are met, the Employment Retirement Income Security Act (ERISA) preempts common law bad faith causes of action against insurers who provide group insurance policies as employee benefit plans.157

Furthermore, because Missouri courts treat bad faith actions as actions in tort, not in contract,158 the defense of comparative fault might be available to insurers in the bad faith context.159

Finally, the implied duty of good faith and fair dealing is mutual; it is owed by both the insurer and the insured.160 As such, it has been argued that an insurer should not be subjected to a bad faith cause of action if the insured acted in bad faith.161 Examples of an insured's bad faith include procuring a policy through fraud and breaching contractual obligations.162 The availability of this defense, recognized and adopted in California,163 remains to be determined in Missouri. Additionally, if this affirmative defense is recognized, the question arises

152. Id. (citing State Farm Mut. Auto. Ins. Co. v. Superior Court, 279 Cal. Rptr. 116, 118 (Ct. App. 1991)).
153. Id. at 121. (citing Allen v. Allstate Ins. Co., 656 F.2d 487, 489-90 (9th Cir. 1981)).
154. Id.
155. Id. at 119.
156. Id.
157. Id. at 127. See supra note 59 and accompanying text for the statutory requirements.
158. Zumwalt v. Utilities Ins. Co., 228 S.W.2d 750, 753-54 (Mo. 1950).
160. Richmond, supra note 151, at 128.
161. Id. at 131.
162. Id.
whether an insurer then may sue the insured for breach of the implied duty of good faith and fair dealing. This issue of "reverse bad faith" has not been addressed by Missouri.\(^\text{164}\)

\section*{E. Damages}

The damages recoverable in a bad faith refusal to settle action "equal the amount of money which the insured was forced to pay on the claim not settled by virtue of a judgment of liability in excess of the policy limits."\(^\text{165}\) In other words, the insurer, found liable for a bad faith refusal to settle, is liable for the entire judgment against the insured, including the portion of the award that is in excess of the policy limits.

\subsection*{1. Punitive Damages\(^\text{166}\)}

An allegation of bad faith on the part of an insurer is not sufficient, in itself, to state a claim for punitive damages.\(^\text{167}\) Before punitive damages can be awarded, the insured first must allege in the pleadings facts indicating that the insurer maliciously, willfully, intentionally, or recklessly injured the insured by its tortious act.\(^\text{168}\) The insured must then show that the insurer committed a wrongful act, knowing it to be wrongful, without just cause or excuse.\(^\text{169}\)

\subsection*{2. Attorney's Fees}

The Missouri Supreme Court has stated that attorney's fees are recoverable only when they are provided for by contract or statute,\(^\text{170}\) as an item of damages

\begin{footnotesize}
\begin{enumerate}
\item For a detailed discussion of this issue, see Douglas R. Richmond, \textit{Insured's Bad Faith as Shield or Sword: Litigation Relief for Insurers?}, 77 MARQ. L. REV. 41, 61 (1993).
\item \textit{See supra} Part III, Section F, Subsection 3 of this Comment for a discussion of Missouri's general rules regarding punitive damages awards.
\item Dyer, 541 S.W.2d at 706.
\item \textit{Id.} (citing Zumwalt, 228 S.W.2d at 756).
\item \textit{Id.} (citing Yost v. Household Fin. Corp., 422 S.W.2d 382, 385 (Mo. Ct. App. 1976)).
\item Arnold v. Edelman, 392 S.W.2d 231, 239 (Mo. 1965) (citing Willis v. American Nat'l Life Ins. Co., 287 S.W.2d 98, 107 (Mo. Ct. App. 1956)).
\end{enumerate}
\end{footnotesize}
incurred in collateral litigation, or when a court of equity finds punitive damages necessary to balance the benefits.171

Relying on notions of equity, a federal court allowed recovery of attorney's fees when an insurer's failure to settle was in bad faith.172 The court concluded, based on a proximate cause argument, that the insurer's "acts of omission gave rise to the necessity for the employment of counsel, and unless plaintiff can be reimbursed for this expenditure, then the damages as assessed will not compensate it for the damages suffered on account of the acts of defendant."173 The court was of the view that, under the circumstances, reasonable attorney's fees incurred and paid by the insured may be recovered from the insurer as an element of damage suffered.174 The defendant's bad faith in failing to settle was the proximate cause of the insured's suit, and the attorney's fees were a proper element of damages resulting therefrom.175

In some situations, the insurer may pursue a declaratory judgment action to determine whether coverage exists.176 Missouri Revised Statutes Section 527.100 provides, "In any proceeding under Sections 527.010 to 527.130 the court may make such award of costs as may seem equitable and just." Thus, "costs" under Section 527.100 may include attorney's fees.177 Awards of attorney's fees are left to the broad discretion of the trial court and will not be overruled except for an abuse of discretion.178 Furthermore, courts are held to be experts on attorney's fees.179 Factors that a judge should use to determine the reasonable value of legal services include: time spent, nature and character of services rendered, nature and importance of the subject matter, degree of responsibility imposed on the attorney, value of property or money involved, degree of professional ability required, and the result.180 However, an insured will not be able to recover attorney's fees if unresolved issues of fact and law

171. Id. (citing Duncan v. Townsend, 325 S.W.2d 67, 71 (Mo. Ct. App. 1959)).
172. Maryland Cas. Co. v. Elmira Coal Co., 69 F.2d 616, 620 (8th Cir. 1934).
173. Id.
174. Id.
175. Id.
176. The mere filing of a declaratory judgment action by the insurer to determine the construction its own policy does not necessarily insulate the insurer from a bad faith claim. BECKERMAN, supra note 124, at 40.
179. Id.
justify the insurer's bringing of the action, in good faith, to determine the insured's obligations.\textsuperscript{181}

VI. FAILURE TO DEFEND

Two different causes of action may exist when an insurer obligated to provide a defense fails to do so. If the insurer does not provide a defense when the insurance policy requires, the insurer has breached the contract. Furthermore, insurance policies contain implied covenants of good faith and fair dealing that prohibit either party from doing anything that will injure the other party's right to receive the benefits of its agreement. Thus, an insurer who acts in bad faith when failing to provide a defense may find itself subject to both a breach of contract claim and a bad faith claim.

To establish a cause of action for breach of contract and bad faith failure to defend, one must establish that a duty to defend existed. The first step is to determine which state law governs. The criteria for determining which state law governs contractual disputes was recently set out by the Missouri Court of Appeals for the Western District:

Missouri uses the criteria contained in Sec. 188, The Restatement (Second) of Conflicts of Law (1971), in choice of law situations dealing with contracts. The contacts to be weighed and evaluated are: (1) the place of the contract; (2) the place of negotiation of the contract; (3) the place of performance; (4) the location of the subject matter of the conflict; and (5) the domicile, residence, nationality, place of incorporation and place of business of the parties.\textsuperscript{182}

After the applicable state law is determined, the next step is to determine whether the duty to defend exists. The insurer's duty to defend is broader than its duty to indemnify.\textsuperscript{183} The duty to defend is determined by comparing the language of the policy with the allegations of the insured's petition.\textsuperscript{184} If the complaint alleges facts which state a claim potentially or arguably within policy


\textsuperscript{184} Id.
coverage, there is a duty to defend. 185 Recall, however, that parties to insurance policies may contractually limit the duty to defend. 186

Despite the foregoing analysis, if coverage is at issue and the existence of the duty to defend is nevertheless uncertain, the liability insurer has three options. 187 First, the insurer simply can defend the suit. 188 Second, the insurer can defend the suit under a reservation of rights. 189 With this option, the insurer can litigate the case and later raise the issue of coverage. 190 Third, the insurer can refuse to defend the insured. 191 Under this approach, the insurer risks a breach of contract action if coverage does in fact exist. 192

A. Breach of Contract Action

In Missouri, a cause of action exists for breach of contract when an insurer, obligated to provide a defense, fails to do so. 193 The cases consistently hold that when it is the insurer's duty to defend, and the insurer wrongfully refuses to do so on the mistaken belief that the claim is not within the coverage of the policy, the insurer is liable to the insured for all damages resulting to him as a result of such breach. 194 This breach of contract action exists even if the insurer acts in good faith and reasonably believes that there is no coverage under the policy. 195

185. Id.
186. Id. (citing State Farm Fire & Cas. v. Metcalf, 861 S.W.2d 751, 754-55 (Mo. Ct. App. 1993). The court stated:
The public policy exception to the general principle of freedom to contract in insurance policies is limited by the statute in which the exception is based, section 303.190.2 RSMo. 1986. The statute is designed to protect injured people who are hurt by negligent drivers. The contractual obligation to defend is a protection provided to the insured, not the injured person. Because the benefit of this provision inures to the insured and not the innocent, injured person, it does not violate public policy to allow the parties to contractually limit this duty.

188. Id. at 485-86.
189. Id. at 486.
190. Id.
191. Id.
192. Id.
194. Landie, 390 S.W.2d at 562 (Mo. Ct. App. 1965).
195. Id. ("Thus the universal rule which Missouri follows is that an insurance
By refusing to defend, "the insured is released from the policy prohibition against incurring expenses and negotiating and settling claims." The insured then may take any reasonable steps necessary to protect its interest. And if it is determined that the insured, in fact, had an obligation to defend, the insurer becomes "obligated to reimburse the insured for such settlement, absent collusion, ..."

B. Bad Faith Failure to Defend

An insurer who acts in bad faith when failing to provide a defense may find itself subject to both a breach of contract claim and a bad faith claim. This is due to the covenant of good faith and fair dealing implicit in all contracts, including insurance contracts. This implied covenant prohibits either party from doing anything that will injure the other party's right to receive the benefits of its agreement.

The bad faith failure to settle claim and the bad faith refusal to defend claim involve two separate duties and are treated in different manners.

[A]n insurer's duty to defend is distinct and different from its duty to settle a claim against its insured within the policy limits when it has the chance to do so. It is also clear that a "bad faith" action for refusal to settle sounds in tort, not in contract.

The duty to defend, on the other hand, is contractual, and this duty is a protection provided to the insured, not the injured person.

company is liable to the limits of the policy plus attorney fees, expenses and other damages where it refuses to defend an insured who is in fact covered. This is true even though the company acts in good faith and has reasonable ground to believe there is no coverage under the policy.

196. Id.
197. Id.
198. Id.
199. Lee, supra note 2, at 718.
C. Damages

The damages resulting from an insurer's failure to defend where there is coverage is analogous to the measure of damages for a breach of contract. The insurer will be responsible for "all damages reasonably flowing from such a breach so as to put the insured in as good a position as he would have been in if the company had performed its contract."202 The insurer is liable to its insured up to the limits of the policy plus attorney fees, costs, interest and other expenses incurred by the insured in conducting the defense where it refuses to defend an insured who is in fact covered.203

1. Punitive Damages

When the cause of action for failure to defend purely is for a breach of contract, the general rule that punitive damages are not awarded for breach of contract claims is applicable.204 However, there is an exception to the general rule denying punitive damages when a plaintiff alleges and proves a breach that amounts to an independent and willful tort.205 The Missouri courts have yet to address the applicability of the general rule and its exception to situations involving a plaintiff who shows bad faith in the insurer's refusal to defend. Other jurisdictions addressing this issue are split regarding whether punitive damages are recoverable in an action based on an insurer's bad faith refusal to defend.206

203. Id.
205. Id.
206. Ryder Truck Rental, Inc. v. UTF Carriers, Inc., 790 F. Supp. 637, 640 (W.D. Va. 1992) (Virginia law does not recognize a claim against insurer for punitive damages based upon a theory that insurer failed to defend or satisfy claim against its insured in good faith). Connecticut appears to recognize a tort remedy for an insurer's bad faith breach of its duties under its insurance contracts. Id. New York courts treat bad faith claims against insurers as contract claims and allow damages punitive in nature and measure by allowing damaling in excess of policy limits in egregious contract cases. Id. See also Indiana Gas Co. v. Aetna Cas. & Sur. Co., 951 F.Supp 759, 764 (N.D. Ind. 1996); Broadhead v. Hartford Cas. Ins. Co., 773 F. Supp. 882, 905 (S.D. Miss. 1991) (under Texas law, where duty to deal fairly and in good faith with insured is breached by insurer with conscious indifference to rights of insured, punitive damages may be awarded); Cuson v. Maryland Cas. Co., 735 F. Supp. 966, 970 (D. Haw. 1990) (punitive damages are recoverable in breach of contract case); Tan Jay Int'l Ltd. v. Canadian Indem. Co., 243 Cal. Rptr. 907, 913 (Ct. App. 1988) (allowing punitive damages for a failure to defend); Erie Ins. Co. v. Hickman, 622 N.E.2d 515, 519 (Ind. 1993) (the district court could not rule as a matter of law that the Indiana Supreme Court would not
2. Attorney's Fees

The insurer is liable to its insured "to pay any judgment against him up to the limits of the policy plus attorney fees, costs, interest and other expenses incurred by the insured in conducting the defense."207 Thus, upon the refusal of an insurer to defend its insured, the insurer becomes liable for attorney's fees incurred by the insured in defending an action.208 However, attorney's fees incurred in bringing the suit against the insured for damages for failure to defend are not recoverable.209 Further, the "universal rule" expressed in Landie was in the context of attorney's fees incurred at the trial court level. However, additional attorney's fees, incurred on an appeal taken by the insured from an adverse judgment where the insurer has denied coverage and refused to defend, may also be recovered.210

Furthermore, in addition to attorney's fees, if a bad faith failure to settle is proven, then the insurer also may be held liable for that portion of the judgment in excess of the policy limit.211

D. Defenses

As the failure to defend is a contractual cause of action, the defenses to normal contract actions are available. Many of the defenses discussed in the context of first-party actions and third-party bad faith failure to settle actions are equally applicable in the refusal to defend context.

In order to make out a claim for a failure to defend, the plaintiff must first show that such a duty existed:

recognize a cause of action in tort for the breach of a duty of good faith in the context of a breach of a duty to defend a third-party claim); Farris v. United States Fidelity & Guar. Co., 587 P.2d 1015, 1023 (Or. 1978) (an insurer's bad faith refusal to defend its insured under a liability policy gives rise only to a breach of contract claim for which punitive damages cannot be recovered).

207. Landie, 390 S.W.2d at 562 (emphasis added).
210. Heshion Motors v. Western Int'l Hotels v. American Motorists Ins. Co., 600 S.W.2d 526, 539 (Mo. Ct. App. 1980) (holding that the insured is entitled to recover for the additional attorney's fees incurred during the appeal).
211. See supra Part II of this Comment for a more thorough analysis of this proposition.
The duty of a liability insurer to defend is determined by comparing the policy language and the allegations of the petition in an action brought by a person injured. If the complaint alleges facts which state a claim potentially or arguably within policy coverage, there is a duty to defend.212

However, parties to insurance policies may contractually limit the duty to defend. The insurer can negate the existence of a duty to defend by establishing that the insured's claim fell within a policy exclusion.213

Breach of contract actions are governed by a five-year statute of limitations.214 Such actions are not deemed to accrue when the wrong is done or the technical breach of contract or duty occurs, but when the last item of damages resulting therefrom is sustained and is capable of ascertainment.215 Damage is sustained and capable of ascertainment for purposes of the statute of limitations when it can be discovered or made known, even if the amount of damage is unascertained.216 When the damage becomes capable of ascertainment, the statute of limitations is put in motion.217

VII. BAD FAITH FAILURE TO SETTLE
AND FAILURE TO DEFEND

In the bad faith failure to settle and failure to defend situation, the insurer has breached two duties owed to the insured: the duty imposed by the policy to defend the insured, and the duty to exercise good faith in considering an opportunity to settle a claim within policy limits when a demand for settlement is made by the insured. Thus, the insurer has refused to defend the insured, and, while persisting in such refusal to defend, the insurer also has refused to settle the suit against its insureds within the limits of the policy, although such settlement was demanded by the insured. "[A]n insurer's duty to defend is distinct and different from its duty to settle a claim against its insured within its policy limits when it has a chance to do so. It is also clear that a 'bad faith' action for refusal to settle sounds in tort, not in contract. . . ."218 The duty to defend, on

213. Id.
217. Id.
the other hand, is contractual and is a protection provided to the insured, not the injured person.\textsuperscript{219}

When the failure to defend and failure to settle both are present, the question becomes the extent to which the insurer is liable for the judgment in excess of the policy limits. The insurer may argue that the breach of contract should not exceed the policy limits since the insurer has not assumed control of the defense. However, this argument has been rejected by the courts.\textsuperscript{220}

In \textit{Landie v. Century Indemnity Co.}, the court was confronted with the task of applying the well-settled rules for failure to settle and failure to defend to a situation in which both were present in the same case.\textsuperscript{221} The \textit{Landie} court first pointed out that a company "which breached its contract by failure to defend could not thereby be put in a better position than a company which honored its contract and did defend."\textsuperscript{222} Otherwise, insurers who refused both to defend and to settle would be protected by the policy limits while those who provided a defense but refused to settle could be liable beyond the policy limits.

In fixing damages for breach of contract, the insured is entitled to be put in as good a position as he would have been in had the insurer honored the contract.\textsuperscript{223} When there is no bad faith failure to settle, this can be accomplished by requiring the company to pay the judgment within the limits of the policy, plus attorney's fees and other related expenses incurred by the insured in his defense of the lawsuit.\textsuperscript{224} However, this same remedy would not make the insured whole when there is wrongful refusal to settle within the limits of the policy.\textsuperscript{225}

Where the company performs it [sic] contract and defends the suit, the insured has a right to good faith consideration by the company of settlement offers within the limits of the policy. If the company refuses, in bad faith, to settle within the limits, the insured can recover the full amount of the judgment in excess of the policy limits from the company. Thus it follows that where the company breaches its contract and refuses to defend, the insured can only be put in as good a position as he would have been in had not the contract been breached, if the company is required to give good faith consideration to offers of settlement within the limits of the policy, and the insured is given the right

\begin{flushright}
221. \textit{Id}.
222. \textit{Id.} at 564.
223. \textit{Id}.
224. \textit{Id}.
225. \textit{Landie}, 390 S.W.2d at 564-65.
\end{flushright}
to recover judgment in excess of the policy limit when settlement within these
limits is refused in bad faith by the company. 226

VIII. RELATED CAUSES OF ACTION

Breach of contract, fraud and negligence are three common law causes of
action related to the third-party bad faith claims.

As discussed earlier, a cause of action exists for breach of contract when an
insurer, obligated to provide a defense, fails to do so. 227 If this breach is
accompanied by a bad faith failure to settle, the insurer may be liable for the
entire judgment, including the amounts in excess of the policy limits.

Missouri recognizes many situations in which a cause of action based on
fraud exists, including insurance cases. For example, parties have alleged fraud
in the valuation of damaged property. 228 Also, there have been instances in
which insurers have alleged that the insureds are guilty of fraud in the execution
of an agreement pursuant to Missouri Revised Statutes Section 537.065. 229
Section 537.065 allows a claimant and a tort-feasor contractually to limit
recovery to specified assets or insurance coverage. The agreement between the
claimant and tort-feasor is valid if it is free from collusion or fraud. 230 However,
no reported Missouri cases deal with the situation in which an excess verdict
results in a fraud claim between an insurer and insured.

Even though several states, such as Kansas and Iowa, recognize a
negligence cause of action against an insurer when a judgment in excess of the
policy limits results, Missouri does not. In Zumwalt v. Utilities Insurance Co.,
the Missouri Supreme Court carefully considered this problem of an insurer's
bad faith failure to settle within the policy limits and concluded that such an
action was not based on negligence. 231 However, nothing seems to bar an action
based on the insurer's negligence giving rise to the unfavorable verdict.

Missouri Revised Statutes Section 375.1000.2, the Unfair Claims
Settlement Practices Act, states, "Nothing in sections 375.1000 to 375.1018 shall
be construed to create or imply a private cause of action for violation of sections

226. Id.
227. Bonner v. Automobile Club Inter-Ins. Exch., 899 S.W.2d 925, 928 (Mo. Ct.
    App. 1995); Butters v. City of Independence, 513 S.W.2d 418, 425 (Mo. 1974); Landie,
    390 S.W.2d at 562.
    (absent fraud, misrepresentation or collusion, the valuation in a fire insurance policy is
    conclusive upon the parties).
229. See supra Part VIII.
375.1000 to 375.1018." Therefore, in bad faith litigation cases, statutory breaches normally are not a factor.

IX. DISCOVERY

A. Evidence

The focus of discovery in bad faith cases is on the conduct of the insurance company. A wide range of evidence may be used to support a claim of bad faith, from a failure to keep the insured fully informed of all significant developments in the claim, to the failure to take an appeal following the verdict in excess of the policy limits when there are grounds to do so. The manner and method of discovery in a bad faith refusal to settle claim obviously vary from case to case. However, the general focus is on the decision of the insurer in refusing to settle the claim. Discovery invariably includes the basis for the insurer's decision in addition to identification of all documentation or other information used by the insurer to support this decision.

A comprehensive set of interrogatories should be served on the insurer at the earliest opportunity in the litigation. Obviously, this should be done prior to taking any depositions. The interrogatories should ask the insurance company to identify all persons who worked on the underlying claim, including those persons who were involved in the insurance company's decision to refuse to settle. Interrogatories also can be used to determine the insurer's basis for refusing to settle and to identify all documentation or other information used by the company to support this decision.

Typically the most important aspect of plaintiff's discovery requests will be directed to the production of the insurer's documentation. A request for production should begin with a request for the insurance company's entire claims file. In addition to the claims file, a request for production also should include the following:

1. A complete copy of plaintiff's insurance policy;
2. All correspondence, memoranda or other documents relating to the handling of the underlying claim;
3. All internal correspondence, memoranda or other documents relating to the evaluation of the underlying claim;
4. All correspondence, memoranda or other documents relating to the insurer's decision relating to or supporting the insurer's decision to refuse to pay the underlying claim;

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232. Part IX was completed with the assistance of John Simon, a partner at the law firm of Gray and Ritter, St. Louis, Missouri. Gray and Ritter is a plaintiff's litigation firm, thus, the discovery discussion takes the plaintiff's perspective.
5. All investigative reports, medical records, or other documentation in the insurer's possession at the time of its decision to refuse to pay the underlying claim;
6. All manuals or other documents containing any written policies or procedures of the insured regarding the evaluation, handling, or settlement of claims.

The attorney should give consideration to taking the deposition of each person who was involved either in the handling of the underlying claim or in the insured's decision to refuse to settle the claim.

Taking a deposition of the insurance company itself, pursuant to Missouri Supreme Court Rule 57.03(b)(4), also can be very helpful. Rule 57.03(b)(4) requires that the insurer produce a representative to testify on its behalf as to specifically designated matters. The notice may also be sent with a request to produce pursuant to Rule 57.03(b)(3). A Rule 57.03(b)(4) deposition is particularly effective because the person so designated by the insurer is required to testify as to all matters known or reasonably available to the insurance company.

A Rule 57.03(b)(4) deposition should request that the insurer produce a particular person to testify to the following matters:
1. All information known to the insurer at the time it made its decision to refuse to settle the underlying claim;
2. All steps taken or efforts made by the insured to investigate the underlying claim;
3. The authenticity of all documents relating to the underlying claim which were in the insured's possession at the time of its decision to refuse settlement;
4. The identity of all employees of the insurer who were involved in any way in handling the subject claim or involved in the insurer's decision to refuse to settle;
5. All policies, procedures, rules and regulations of the insurer regarding the handling and evaluation of claims.

B. Effect of Privileges on Discovery

Most likely, the insurer will object to discovery requests based on any one of three privileges: the attorney-client privilege, the insurer-insured privilege, or the work-product rule.
1. Attorney-Client Privilege

Confidential communications between an attorney and his client are absolutely privileged from disclosure against the will of the client. Where legal advice of any kind is sought from an attorney in his capacity as such, the confidential communications relevant to that purpose are permanently protected from disclosure by both the client and the attorney. Documents falling within the attorney-client privilege also are protected. However, this privilege may be waived by voluntary disclosure of information inconsistent with the confidential nature of the attorney-client relationship.

The attorney-client privilege simply is not available to the insurer as a means to object to the discovery of communications between the insured and insurer. First, the communications are not between an attorney and client. Second, if this privilege does exist, it belongs to the client. The client filing suit and seeking discovery of the information surely satisfies the waiver requirements.

2. Insurer-Insured Privilege

In *State ex rel. Cain v. Barker*, the Missouri Supreme Court stated that an insurer-insured relationship receives the same protection as the attorney-client relationship. This congruent protection is necessary because the insured delegates the selection of an attorney and the defense of any litigation to his liability insurer. Thus, the insured assumes the communications between the insurer and the insured are made for the purpose of transmitting such information to an attorney for the protection of the insured. Public policy encourages the insured to make a full report to his insurer without fear of discovery by an adverse party. However, in bad faith cases, this rationale simply does not apply because the insurer and insured are adversaries. Following this logic, Missouri courts have not recognized the insurer-insured privilege in bad faith cases.

233. Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 601 (8th Cir. 1978).
234. *Id.* at 602.
235. Gray v. Bicknell, 86 F.3d 1472, 1482 (8th Cir. 1996) (citing Mo. Sup. Ct. R. 56.01(b)(1)).
236. *Id.*
237. 540 S.W.2d 50, 53 (Mo. 1976).
238. *Id.* at 54.
239. *Id.*
240. *Id.*
241. See *State ex rel. Safeco Nat'l Ins. v. Rauch*, 849 S.W.2d 632 (Mo. Ct. App.).
3. Work Product Rule

The work product rule states that "information or materials assembled by or for a person in anticipation of litigation or in preparation for trial may be qualifiedly privileged from disclosure to an opposing party." 242 There is a conflict among the courts as to whether a "bad faith exception" to the work product doctrine exists. In Central National Insurance Co. v. Medical Protective Co., the court pointed out that work product is clearly a qualified privilege that can be defeated by good cause. 243 Because communications pertaining to settlement negotiations are at the heart of a bad faith failure to settle claim, the court concluded that good cause was established when the insured filed his claim. 244 Thus, the insured was allowed to discover documents and information relating to settlement negotiations in a claim against the insurer. 245

C. Recent Developments

In Morris v. J.C. Penney Life Insurance Co., 246 the plaintiff contended that a defendant-insurer's uncooperative behavior in discovery was relevant to a vexatious refusal claim. The court rejected defendant's argument and stated that "a defendant has the right to defend an action with all the weapons at its command so long as it has reasonable grounds to believe its defense is meritorious." 247

In State ex rel. Safeco National Insurance Co. v. Rauch, 248 the court held that the 'insureds' filing of an uninsured motorist claim against insurer created [an] 'adversarial environment,' so that workers, to discover work product material potentially included within the investigation file, would be required to...
make the requisite showing of substantial need and inability without undue hardship to obtain substantial equivalent." The court also held that this work product privilege was not waived by the insurer's reliance on the affirmative defense of insureds' failure to comply with the assistance and cooperation conditions of the policy.249

The court also addressed the insurer's contention that dismissal of the insured's vexatious refusal to pay claim made the discovery of materials in the investigation file irrelevant. But as the court pointed out, "the propriety of discovery is a matter of discretion for the trial court, the relevance of any particular discoverable materials sought is a determination to be made initially by the trial court."²⁵⁰

X. CONCLUSION

This Comment addressed first-party vexatious refusal to pay actions and third-party actions arising from an insurer's bad faith failure to settle, breach of a contractual duty to defend, and bad faith refusal to defend. The recent evolution of bad faith claims often has left insurers with adverse judgments far exceeding insurance policy limits. With so much at stake, this area of law should continue to be hotly contested by both plaintiffs' and insurers' lawyers.

ANTHONY G. FUSSNER

249. Id. at 635.
250. Id. at 636.