# I. EMERGING ISSUES AND CURRENT LAWS

## A. New Case Law Developments

### 1. 'Abnormal' Bad Faith and the Breach of Contract Requirement

There is no statutory bad faith cause of action in Alabama, unlike many other jurisdictions. A significant recent case law development is set forth in State Farm v. Slade 747 So.2d 293 (Ala. 1999) wherein the Alabama Supreme Court held that even in a case of "abnormal" bad faith, the plaintiff must show that the insurer breached the contract when it refused to pay the insured's claim. In White v. State Farm, 953 So.2d 340 (Ala. 2006), the Alabama Supreme Court provided a comprehensive discussion of the status of the law of bad faith and the impact of the Slade decision:

> This Court in two recent cases has provided comprehensive discussions of the tort of bad-faith failure to pay an insurance claim. In *Employees' Benefit Ass'n v. Grissett*, 732 So.2d 968 (Ala. 1998), we stated:
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> "*[National Security Fire & Casualty Co. V. Bowen*, 417 So.2d 179 (Ala. 1982),] set out these requirements for a plaintiff to prove a bad-faith failure to pay:
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> "'(a) an insurance contract between the parties and a breach thereof by the defendant;
> "'(b) an intentional refusal to pay the insured's claim;
> "'(c) the absence of any reasonably legitimate or arguable reason for that refusal (the absence of a debatable reason);
> "'(d) the insurer's actual knowledge of the absence of any legitimate arguable reason to refuse to pay the claim.'
> "417 So.2d at 183. Requirements (a) through (d) represent the 'normal' case. Requirement (e) represents the 'abnormal' case.
> "The rule in 'abnormal' cases dispensed with the predicate of a preverdict JML [judgment as a matter of law] for the plaintiff on the contract claim if the insurer had recklessly or intentionally failed to properly investigate a claim or to subject the results of its investigation to a cognitive evaluation. *Blackburn v. Fidelity & Deposit Co. of Maryland*, 667 So.2d 661 (Ala. 1995);

*Thomas v. Principal Financial Group*, 566 So.2d 735 (Ala. 1990). A defendant's knowledge or reckless disregard of the fact that it had no legitimate or reasonable basis for denying a claim may be inferred and imputed to an insurer when it has shown a reckless indifference to facts or proof submitted by the insured. *Gulf Atlantic Life Ins. Co. v. Barnes*, 405 So.2d 916, 924 (Ala. 1981).
"So, a plaintiff has two methods by which to establish a bad-faith refusal to pay an insurance claim: he or she can prove the requirement necessary to establish a 'normal' case, or , failing that, can prove that the insurer's failure to investigate at the time of the claim presentation procedure was intentionally or recklessly omissive."

732 So.2d at 976 (footnote omitted).

In *State Farm Fire & Casualty Co. v. Slade*, 747 So.2d 293 (Ala. 1999), we elaborated on the rule in the "abnormal" case:

"[W]e reject the Slades' argument that in the abnormal bad-faith case in which the insurer fails to properly investigate the insured's claim contractual liability is not a prerequisite to bad-faith liability, and the Slades' argument that the tort of bad faith provides a cause of action that is separate and independent of an insurance contract. In so doing, we make it clear that in order to recover under a theory of an abnormal case of bad-faith failure to investigate an insurance claim, the insured must show (1) that the insurer failed to properly investigate the claim or to subject the results of the investigation to a cognitive evaluation and review and **(2) that the insurer breached the contract for insurance coverage with the insured when it refused to pay the insured's claim.**

"This is nothing new. Under the elements established in *[National Security Fire & Casualty Co. v. ] Bowen,* [417 So.2d 179 (Ala. 1982)], the plaintiff has always had to prove that the insurer breached the insurance contract. Practically, the effect is that in

> order to prove a bad-faith-failure-to-investigate claim, the insured must prove that a proper investigation would have revealed that the insured's loss was covered under the terms of the contract."
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> 747 So.2d at 318. In *Singleton v. State Farm Fire & Casualty Co.*, 928 So.2d 280, 283 (Ala. 2005), we reviewed the discussion in *Slade* of the previously recognized distinction between "normal" and "abnormal" bad-faith cases: "In the 'normal' bad-faith case, the plaintiff must show the absence of any reasonably legitimate or arguable reason for denial of a claim. *[State Farm Fire & Cas. Co. v.] Slade*, 747 So.2d [293] at 306 [(Ala. 1999)]. In the 'abnormal' case, bad faith can consist of: 1) intentional or reckless failure to investigate a claim, 2) intentional or reckless failure to properly subject a claim to a cognitive evaluation or review, 3) the manufacture of a debatable reason to deny a claim, or 4) reliance on an ambiguous portion of a policy as a lawful basis for denying a claim. 747 So.2d at 306-07....
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> "'Bad faith . . . is not simply bad judgment or negligence. It imports a dishonest purpose and means a breach of known duty, i.e., good faith and fair dealing, through some motive of self-interest or ill will.' *Slade* 747 So.2d at 303-04 (quoting *Gulf Atlantic Life Ins Co. v. Barnes*, 405 So.2d 916, 924 (Ala. 1981))."
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> 953 So.2d at 347-349 (emphasis supplied)

In many recent cases the Slade "breach of contract" rationale has been relied upon in affirming the grant of summary judgment for the insurer. For instance, in Parker v. J.C. Penney Life Ins. Co., 2007 WL2405074 (Ala.Civ.App.2007), a mother and stepfather brought an action against an insurer for failure to pay a life insurance claim arising from the death of a child. The Parker court quickly disposed of a bad faith claim following a lengthy discussion wherein the court held that the trial court correctly entered summary judgment on the insureds' breach of contract claim and thus, there was no bad faith cause of action based upon the Slade holding.

**2. Bad Faith in Uninsured Motorist Context - Recent Case Law**

Many recent cases have examined bad faith claims in the uninsured motorist insurance context. In National Assurance Ass'n v. Sockwell, 829 So.2d 111 (Ala. 2002) the Alabama Supreme Court affirmed an award of compensatory damages and punitive damages in favor of an insured arising out of the investigation and delayed payment of underinsured motorist benefits. In Sockwell, the insureds suffered serious bodily injury in a motor vehicle accident and the negligence of an underinsured driver was undisputed. At the time of the accident Sockwell was working within the line and scope of her employment. The underinsured motorist carrier denied payment of the UIM claim on two occasions on the basis that the underinsured motorist coverage excluded payment for any loss covered under a worker's compensation law. However, the specific exclusion forming the sole basis for denial, the worker's compensation limit of liability provision, had been declared void in a 1971 Alabama Supreme Court case. See, State Farm v. Cahoon, 287 Ala. 462, 252 So.2d 619 (1971).

The Sockwell court affirmed the plaintiff's verdict on the basis that the denial of UIM coverage was made on a specific basis, to wit, the admittedly void exclusion. The Sockwell court further found that there was evidence of bad faith as a result of the fact that the insurer took no action to delete provisions from its standard policy that it knew was void. The Sockwell case is one of the few cases wherein a bad faith cause of action was found to exist in the uninsured motorist context.

In three recent cases, Alabama appellate courts have found no liability for the insurer. In Federated Mutual Ins. Co. v. Vaughn, 961 So.2d 816 (Ala. 2007), the Alabama Supreme Court found that an employer could reject uninsured motorist coverage for certain insured employees while accepting it for another group of employees, including directors, officers, partners and owners. In the Vaughn case, the insured brought a bad faith failure to investigate claim, in addition to a breach of contract claim. Because the Vaughn court held that the insurer did not breach the contract when it refused to pay the claim, the Alabama Supreme Court, relying solely upon Slade, affirmed a grant of summary judgment for the insurer.

In State Farm v. Smith, 956 So.2d 1164 (Ala.Civ.App. 2006), the Alabama Supreme Court reversed a jury verdict in favor of an insured against an uninsured motorist carrier. In Smith, a State Farm insured was severely injured in an accident caused by the negligence of a driver whose policy limits were $25,000.00. The State Farm UIM limits provided a combined total of $50,000.00 in UIM coverage. Notwithstanding the clear liability, significant injury and low underlying limits, State Farm refused to pay the UIM benefits. Smith then argued that State Farm's refused to pay benefits amounted to "abnormal" bad faith because State Farm failed

to adequately investigate the claim or to submit the results of the investigation to cognitive evaluation and review. Because there was evidence that State Farm had actually reviewed the medical records and pointed out several discrepancies, including a brief four day delay in the insured initially seeking treatment and because of evidence of some pre-existing complaints, the Smith court found that the insured had not established legal entitlement to payment of the benefits. The Smith court stated as follows:

> Because Smith had not established the extent of his damages and because State Farm disputed whether all of the damages claimed by Smith were attributable to the May 1997 accident, State Farm's decision not to authorize payment of all or part of Smith's UM/UIM benefits could not have amounted to bad faith. 956 So.2d at 1170.

In Morgan v. Safeway Ins. Co., 2007 WL1866768 (Ala.Civ.App. 2007), a UIM insured settled with the tortfeasor and gave his UIM insurer, Safeway, notice of the settlement. In the Safeway case, the insured's attorney sent a letter to Safeway on October 17, 2005 and then forwarded medical bills on October 18, 2005. On October 27, 2005, the insureds entered into an agreement releasing the alleged tortfeasor before receiving any notification from Safeway about its approval of the settlement. Safeway refused to pay any UIM benefits because the insured did not comply with a "reasonable time" standard. The Morgan case suggested that at least thirty days should be given to the insurer to investigate.

**B. Recent Decisions of Interest**

In Akpan v. Farmers Ins. Exchange, 961 So.2d 865 (Ala. 2007), a Farmers' insured suffered a burglary and brought claims under a Farmers policy. Farmers contracted with an independent adjuster to investigate and adjust the claim with Farmers maintaining the right to determine coverage under the policy. The insured refused to submit to an examination under oath (EUO) and then argued that because it had not received a copy of the policy at the time of the loss, the EUO requirement in the policy was waived. The Akpan court affirmed the grant of summary judgment on the basis that the insured was provided a copy of the policy after the loss but before the EUO was scheduled. As a matter of first impression, the Akpan court held that the independent adjuster and its employee owed no duty to the insured.

In Mutual Assurance v. Schulte, 2007 WL 1169223 (Ala. 2007), the Alabama Supreme Court ruled in favor of an insured physician who brought a bad faith failure to settle claims against Mutual Assurance, his medical malpractice insurance provider. In the

underlying case, the doctor suffered a verdict in excess of policy limits. The insurer, MAI, argued that it relied upon a statute, § 6-5-547 which capped punitive damages at an amount within the applicable coverage limits, when making its settlement decision. The Alabama Supreme Court held that the insurer was not entitled to a presumption as a matter of law that reliance on the statute was reasonable.

In Rogers v. State Farm, 2007 WL 2966694 (Ala. 2007), the insured brought an action against his homeowner insurer alleging breach of contract and bad faith refusal to pay. The insured suffered damage to his home as the result of a tornado. The insured and State Farm were unable to agree on an amount of damages and State Farm invoked an appraisal clause in the policy. As a matter of first impression, the Alabama Supreme Court held that an appraiser under a homeowners' insurance appraisal clause was not entitled to determine issues of causation.

## II. CONSIDER THE ETHICAL CONSEQUENCES: IT'S LEGAL BUT IS IT RIGHT?

### A. Advice of Counsel Defense

An insurer can show that it did not act in bad faith via employment of a lawyer in private practice to provide advice regarding a particular issue. In numerous circumstances, Alabama Courts have found that reliance on advice of informed counsel has been sufficient in itself to establish good faith or to rebut a claim of bad faith. Davis v. Cotton States Mut. Ins. Co., 604 So.2d 354 (Ala. 1992); Lynch v. Greentree Acceptance Inc., 575 So.2d 1068 (Ala 1991); Hanson v. Couch, 360 So.2d 942 (ala. 1978).

Alabama does not recognize the advice of counsel defense as insulating the insurer from liability in all cases. In Chavers v. National Sec. Fire & Cas. Co., 405 So.2d 1 (Ala. 1981), the Alabama Supreme Court stated as follows:

> National Security would have us recognize advice of counsel as an absolute defense under the circumstances. While advice of counsel, along with all the other relevant factors, may be considered by the trial judge in his determination whether the strongest tendencies of the evidence, if believed, make out a case for a jury on the "lawful basis for refusal issue", it is not necessarily an absolute defense. Where, as here, the advice of insurer's counsel is not founded on professional evaluation of the credibility of admissible evidence, but is instead confined totally to inadmissible and unproved hearsay

> evidence, absent any ongoing investigation relative thereto, such advice cannot serve, as a matter of law, to insulate the insurer/client from bad faith liability. 405 So.2d at 8.

**B. Ethical Pitfalls in Contacting Witnesses**

In an Office of General Counsel opinion attached hereto, the Alabama State Bar held that contact was permitted with employees of opposing parties who are non-managerial, who are not responsible for the act which the opposing party could be liable and have no authority to make decisions about the litigation. The opinion sets forth at length applicable Rules of professional conduct that control in this context.

Accordingly, the advice of counsel must involve a professional opinion on admissible evidence in order to be considered as a factor.