

**INSURANCE CONSUMER COUNSEL'S COLUMN**  
**"Continuing Development of Insurance Bad Faith in Montana"**

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**I. Introduction and Historical Context Up to the Year 2000**

In the summer 2000 issue of TRIAL TRENDS, the author wrote an article entitled "Development and Status of Insurance Bad Faith in Montana."<sup>2</sup> The article recounted the history of insurance bad faith in Montana reviewing its common law and statutory development and attempted to set forth the status of insurance bad faith at the millennium.

In the intervening seven years since 2000, the state and federal courts in Montana have issued upwards of twenty decisions adding to Montana's bad faith jurisprudence. Hence, it is time to reflect on the continuing development of the tort of insurance bad faith in Montana since the millennium. This work, when coupled with the original article, is designed to provide the reader with a broad understanding of the borders of insurance bad faith in Montana to-date.

**A. A Short History and Development of Insurance Bad Faith to 2000<sup>3</sup>**

*Jessen v. O'Daniel*,<sup>4</sup> was Judge Jameson's 1962 landmark federal decision which recognized an action for extra-contractual damages against an insurer for breach of its duty to settle a claim for the benefit of its insured. That same year, in *Westfall v. Motors Ins. Corp.*, the Montana Supreme Court held that punitive damages were not an available remedy for breach of contract even if the breach was willful or fraudulent.<sup>5</sup> However, in *State ex rel. Larson v. District Court of the Eighth Judicial Dist.*,<sup>6</sup> in 1967, the Court made an exception to the *Westfall* rule that allowed damages where breach of an insurance contract was also a violation of the Montana insurance code. Montana had adopted its insurance code in 1959.<sup>7</sup> However, the code would not contain the Unfair Claim Settlement Practices Act provisions (UTPA) until 1977.<sup>8</sup>

Nevertheless, *Larson* ushered in a new era of bad faith actions based in statute and referred to as "tortious breach of the insurance code." Moreover, in 1977, Montana adopted the Unfair Claims Settlement Practices provisions of the code, a statement of fourteen practices prohibited for insurers.<sup>9</sup> Much of insurance bad faith would ultimately have its basis in that statute, and counsel began to use it as their primary source of duties which might provide a basis for a claim of insurance bad faith.

By 1982, the cases of *Weber v. Blue Cross of Montana*<sup>10</sup> and *Lipinski v. Title Ins. Co.*,<sup>11</sup> established that there existed in Montana a common law tort of bad faith independent of the insurance contract and independent of statute.

Third-party bad faith appeared in Montana with the decision of *Klaudt v. Flink* in 1979<sup>12</sup> which followed the California Supreme Court's landmark 1979 decision in *Royal Globe Ins. Co. v. Superior Court of Butte County*.<sup>13</sup> *Klaudt* held that a third-party claimant in Montana could have a direct private civil right of action against an insurer for breach of MCA § 33-18-201 of the UTPA. Hence, third-party victims could bring bad faith claims against the tortfeasor's insurer for violating the UTPA while handling third-party claims.

In 1984, the Montana Supreme Court, in *Gibson v. Western Fire Ins. Co.*,<sup>14</sup> determined that the insurance contract contains an "implied obligation of good faith and fair dealing by a fiduciary bound by a duty of highest good faith." The Gibson case was based entirely on

judicially created principles of bad faith and not on the UTPA.

In 1987, while riding the tide of “tort reform,” the Montana legislature attempted to substantially restrict insurance bad faith by replacing it with a statutory “independent cause of action.”<sup>15</sup> The statutory independent cause of action, along with breach of contract and fraud were apparently intended to be the only remedies allowed for an insurer’s breach. The statute restricted statutes of limitations for the independent claims<sup>16</sup> and provided an absolute defense if the insurer “had a reasonable basis in law or in fact for contesting the claim or the amount of the claim whichever is in issue.”<sup>17</sup> At the same time, the legislature reformed the state’s punitive damage statute to require that punitive damages be proved in a hearing separate from trial by clear and convincing evidence and actual, as opposed to implied, malice.<sup>18</sup> However, in doing so, the legislature also adopted the standard for determining actual malice from *Owens v. Parker Drilling Co.*<sup>19</sup> (1984) which was more consumer-friendly than the old statutory standard of “malicious, fraudulent or oppressive.”

The broad concept of contract bad faith was dealt a blow in 1990 in *Story v. City of Bozeman* in which the Montana Supreme Court held that there was no cause of action for bad faith for breach of a contract in Montana even if the breach was intentional or malicious.<sup>20</sup> The court reasoned that every contract involved a covenant of good faith and fair dealing, so that breach of that covenant was just a contract breach and would not support a tort claim. However, the court recognized an exception for “special circumstances.” Special circumstances existed where one party to a contract had the greater bargaining power, the other party sought security or peace of mind in the contract, and ordinary contract damages were not an adequate remedy. Subsequently, *Stephens v. Safeco Ins. Co. of America*<sup>21</sup> and *Thomas v. Northwestern National Insurance Co.*<sup>22</sup> (1998) applied those *Story* criteria to the relationship between an insured and an insurer and held that the insured/insurer relationship is a special circumstance in which the insurer is in a fiduciary capacity to the insured. Hence, breach of contract by the insurer could support a claim of bad faith tort for breach of the insurance contract.

Court decisions poked some substantial holes in the 1987 legislature’s attempted statutory restriction of bad faith. In 1993, the Court in *O’Fallon v. Farmers Ins. Exch.*,<sup>23</sup> held that claims adjusters could be sued outside MCA § 33-18-242, since the statute only restricted actions against “insurers.” In *Thomas v. Northwestern National Insurance Co.*,<sup>24</sup> (1998) the Court held that insurer conduct not involved in the “handling of an insurance claim” was not governed by MCA § 33-18-242, so that the carrier’s wrongful conduct in handling of the application and renewal process could support a tort claim for bad faith. The court in *Thomas* reconfirmed that insurers have a duty to act in good faith, and said that duty still exists independent of the insurance contract and statute. The Court said such common law claims exist insofar as they are not in conflict with MCA § 33-18-242. *Thomas* made clear that first-party common law bad faith is still alive to redress the insurer’s wrongful conduct which is not part of the handling of insurance claims.

The greatest rip in the statute’s fabric was the Court’s holding in *Brewington v. Employer Fire Ins. Co.*<sup>25</sup> in 1999, which established that the UTPA, by its terms, did not preempt common law claims for third-party bad faith. The Court noted that subsection (3) of the act which limited actions against the insurers to breach of contract, fraud, or the specified independent actions, by its language, applied only to an “insured” claimant and did not mention third-party claimants.

Finally, in this review, the Court in *Safeco Ins. Co. v. Montana 8<sup>th</sup> Judicial Dist. Court*,<sup>26</sup> (2000) held that a declaratory action to enforce advance payment of medical expenses under *Ridley v. Guaranty Nat'l Ins. Co.*,<sup>27</sup> is not barred by the UTPA and may be brought before the underlying claim has been disposed of by settlement or judgment. Hence, actions to enforce or clarify rights could be brought anytime so long as they do not seek bad faith damages for violation of the UTPA.

## **B. Summary of Bad Faith Insurance Law at the Millennium**

At the millennium, then, Montana law had established that insurers owed a duty of good faith and fair dealing both to their insureds and to third-party claimants independent of contract or statute. The relationship between insurer and insured was identified as a “special relationship” in which the insurer has a fiduciary responsibility to the insured which will support a tort action for bad faith if the contract is breached. Montana recognized both common law and statutory actions for insurance bad faith. First-party insureds could only bring breach of contract, fraud and statutory “independent” actions for wrongful conduct of the insurer in handling claims, but could press common law bad faith actions for the insurer’s conduct involved in the application, contracting and renewal process. Third parties could bring common law bad faith actions for any wrongful conduct of the insurer or could avail themselves of the same statutory remedies as first parties.

Finally, parties could avail themselves of declaratory actions to enforce or clarify rights and duties during the pendency of the claims, and such declaratory actions were not barred by the UTPA. Montana law is unique insofar as third-party actions against insurers under the UTPA are now codified. Such third-party rights never existed in other states or were the subject of common law that has been overturned.<sup>28</sup> Punitive damages are allowed under both common law and statutory bad faith<sup>29</sup> actions in Montana. Finally, insureds in statutory actions under MCA § 33-18-242 (2) need not prove that the insurer’s misconduct is a “general business practice” as required under MCA § 33-18-201. All of the propositions stated in this short summary continue to be true of Montana law as this article is written.

## **II. Four General Categories for Analysis of Bad Faith Cases Since 2000**

Cases pertinent to the law of insurance bad faith and decided by Montana state and federal courts since 2000 and can be arbitrarily grouped into four general categories helpful for discussion. First, there are the cases developing the insurer’s duty to make advance payments. Breach of that duty quickly becomes grounds for a declaratory judgment action and bad faith claims in Montana. Second, the Montana Supreme Court has issued important decisions delineating the role and limits of attorney fees as a remedy in enforcing the duties of the insurers. Third, the boundaries of the insurer’s “reasonable basis” defense under MCA § 33-18-242(5) are being developed and are worth analyzing here. Finally, there are a handful of important decisions involving such topics as wrongful conduct of insurance guaranty funds, ERISA, “comparative bad faith”, and statutes of limitations in bad faith actions that merit coverage here. This article will examine each of these areas.

### **A. Duty of Insurers to Advance Pay Damages**

## 1. History of the Duty: The *Ridley* and *Dubray* Cases

Montana state and federal courts have developed rigorous requirements for advance payment by insurers of certain expenses and damages suffered by third-party claimants. Judicial recognition of this set of duties owed by the insurer to third parties has made advance payment issues a primary source of bad faith claims. Recall that in 1997, in the landmark decision of *Ridley v. Guarantee Nat'l Ins. Co.*,<sup>30</sup> the Montana Supreme Court held that, where liability is reasonably clear, an insurer has an obligation to pay the third party claimant's medical expenses as incurred. The Court reasoned that the claims industry practice of refusing to advance medical expenses pending full settlement was "leveraging" which was a practice violating two provisions of the UTPA.<sup>31</sup>

(6) neglect to attempt in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear;

\* \* \*

(13) fail to promptly settle claims, if liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage. . . .

In *Dubray v. Farmers Insurance Exchange*,<sup>32</sup> in 2001, the Court extended *Ridley's* advance expenses duty to include lost wages. *Dubray* had brought a declaratory action under *Safeco Ins. Co. v. District Court*,<sup>33</sup> to make Farmers continue advance payment of medical expenses pursuant to *Ridley* as well as lost wages and included a prayer for relief for "pain and discomfort, mental distress, inconvenience, and punitive damages." The district court dismissed the declaratory action as "an insurance bad faith claim in disguise." However, the Montana Supreme Court, while upholding the dismissal with regard to "pain and discomfort, mental distress, inconvenience, and punitive damages," held it error to dismiss claims for payment of damages such as medical expenses and lost wages about which liability is reasonably clear and not barred by MCA § 33-18-242 (6) (b). The Court said:

Nothing in *Ridley* suggests that its scope should be categorically limited to medical expenses. Rather, medical expenses are just one of the obligations incurred by victims that mandatory liability insurance laws were designed to alleviate. Lost wages which are reasonably certain and directly related to an insured's negligence or wrongful act are another example.

\* \* \*

The essence of our holding in *Ridley* is that where liability is reasonably clear, injured victims are entitled to payment of those damages which are not reasonably in dispute without first executing a settlement agreement and final release.

The Courts will continue to define the duty to make advance payments. Clearly, *Dubray* is not just limited to lost wages, but includes "those damages which are not reasonably in dispute" which means that such things as travel expense and home care should be the subject of a duty to make advance payment.

## **2. The *Watters* Case and Settlement Without a Release**

Given the scope and size of damages subject to advance payment, the insurer's immediate concern has become obtaining a release for their insured before their limit is paid out in advance payments. The reader should note here that, in 2000, the Court in *Watters v. Guaranty Nat'l Ins. Co.*,<sup>34</sup> held that auto insurers could not demand a release in clear liability cases where the claimant's damages clearly exceeded a minimum limit (\$25,000) BI coverage. The Court held that demanding a release in that circumstance was an unfair trade practice as a violation of the duty "to effectuate prompt, fair and equitable settlements of claims" under MCA § 33-18-242(6). Just as importantly, the Court held it was not *per se* bad faith for an insurer to pay out the \$25,000 BI limit to a claimant without getting a release for its insured, given that the insured had no reasonable expectation of negotiating a release with a minimum limit policy.

## **3. Duty to Advance Pay Without a Release Even Where the Claimant Refused a Limits Offer**

In 2002, in the clear liability case of *Etter v. Safeco Ins. Co. of Illinois*,<sup>35</sup> the insurer offered the auto Bodily Injury coverage limit of \$100,000 conditioned on signing of a full release. The claimant, Etter, refused, counter offering at \$850,000. Safeco then refused to advance pay \$60,000 in medical expenses under *Ridley* contending that, under the 1992 decision of *Juedeman v. National Farmers Union*,<sup>36</sup> plaintiff's refusal of limits relieved them of that duty. (*Juedeman* had held that, where the claimant refused to sign a release, hers was not an offer of "settlement", and the insurer had no duty to accept it.)

The Federal District Court in *Etter* held that claimant's refusal to settle for policy limits does not relieve the carrier of the duty to advance pay medical expenses under *Ridley*. Accordingly, Safeco's failure to advance the medical expenses was bad faith. The Court reasoned that Safeco was obligated to pay so long as: (1) liability is reasonably clear, and (2) the expense is causally related to the accident. The Court asserted that to refuse *Ridley* payments in that situation was leveraging. The Court said whether Safeco could condition a BI limits offer on signing of a release was not the issue in the case. They simply had a duty to advance pay the medicals regardless of the release.

## **4. Duty to Advance Pay Beyond Minimum Limits**

It is now clear that an insurer which has a policy whose limits are greater than the mandatory minimum must pay advance expenses under *Ridley* and *Dubray* up to the limits of its coverage without the benefit of a release. *Shilhanek v. D-2 Trucking, Inc.*<sup>37</sup> (2003), involved the insurer's duty to advance pay medicals beyond the minimum mandatory limits of liability and raised the issue of whether an insurer's refusal to do so is bad faith. The insurer contended that the duty to advance pay without a release only arises under the minimum limits of the Motor Vehicle Responsibility Act, MCA § 61-6-103(2). The Court disagreed saying, "We further conclude that, to the extent that there is language in *Watters* that might be read to imply that the insurer's obligation under *Ridley* is limited to the minimum coverage required by the MVRA, that language is overruled." The Court held that failure to pay undisputed medical expense in advance up to the limits of the tortfeasor's coverage without a release is a violation of MCA §

33-18-201 (6) and (13) (1997). (Notably, in the *Shilaneek* case, the Court ultimately absolved the insurer of bad faith for conditioning payment on a full release, because *Juedeman* (1992) had held it permissible for a carrier to condition settlement upon a release of claims against its insured, and *Watters* (2000), was not yet the law when the insurer acted.) Hence, under MCA § 33-18-242 (5), the carrier had “a reasonable basis in law or fact” for contesting the claim at that time. Today, if liability is clear and damages clearly exceed the minimum limits of BI coverage, it would be bad faith to condition advance payments on a release of the insured from liability even where liability limits exceed the minimum.

#### **5. Duty to Advance Pay Without an “Advance Pay Agreement”**

After *Shilaneek*, the question became whether the insurer could make the claimant sign an advance pay agreement before paying medical expense. The Federal Court in *Burgett v. Safeco National Ins. Co.*<sup>38</sup> (2003), ruled that, under *Shilaneek* in Montana, the third party insurer in a clear liability accident with undisputed damages cannot demand that the claimant sign an advance pay agreement before paying advance medical expense. The insurer has a duty to pay an injured third party’s undisputed medical expenses, up to the limits of its coverage and without the benefit of a settlement agreement.

#### **6. Duty to Advance Pay Under CGL and Homeowners Policies?**

The question yet to be decided by the Courts is whether *Ridley* and *Dubray* apply to such casualty coverages as Commercial General Liability (CGL) and Homeowner Liability policies. Both decisions are based in judicial interpretations of the UTPA, MCA § 33-18-201, but they also discuss public policy as expressed in the Mandatory Liability Protection Act, MCA § 61-6-301 which applies only to auto insurance. Nevertheless, the reasoning of each decision could as easily apply to CGL and Homeowner’s policies and one could reasonably predict that the Court would extend the duty to pay to those policies. One insurance defense lawyer reported to the author that he advises CGL carriers that the Court will likely extend the duty to CGL coverage, but that it should not be bad faith to refuse the duty until the Court does so.

#### **7. A Limit on the Use of Declaratory Actions**

The declaratory action recognized in *Safeco Ins. Co. v. District Court*<sup>39</sup> has great utility in establishing insurer’s duties and claimant’s right at the outset, but the issue brought before the court must present a “justiciable controversy.” In *Miller v. State Farm Mutual Auto. Ins. Co.*<sup>40</sup> (2007), the claimant, Miller, and the tortfeasor, Rosh, were in an auto collision while both were insured by State Farm. State Farm paid Miller \$24,195.04 under his Med Pay coverage, and Rosh had \$100,000 Bodily Injury Liability limits. In settlement negotiations with Miller, State Farm reduced its evaluation of Miller’s third-party claim by the \$24,195.04 Med Pay benefit paid asserting it was entitled to do so under the statutory collateral source rule.<sup>41</sup> Miller filed an action for declaratory judgment, seeking a declaration that the collateral source rule does not apply until there is a judgment or verdict and certainly not in settlement negotiations. The District Court ruled that Miller presented no justiciable controversy.

The question, on appeal to the Montana Supreme Court, was whether the issue of the collateral source rule applying during settlement negotiations presents a justiciable controversy

for purposes of declaratory relief. The court held it does not. It is necessary for a justiciable controversy to exist before a court may exercise jurisdiction under the Uniform Declaratory Judgments Act, MCA § 27-8-101 *et. seq.*. The three part test for justiciable controversy is: 1. “[T]he parties have existing and genuine, as distinguished from theoretical, rights or interests.” 2. “[T]he controversy must be one upon which the judgment of the court may effectively operate. . .”. 3. “[It] must be a controversy the judicial determination of which will have the effect of a final judgment in law or decree in equity upon the rights, status or legal relationships of one or more of the real parties in interest, or lacking the qualities be of such overriding public moment as to constitute the legal equivalent of all of them.”<sup>42</sup> The court reasoned that Miller was “requesting the court to interject its opinion regarding what factors and circumstances parties may consider in negotiating a settlement.” The court said it cannot dictate what factors parties may consider in formulating settlement negotiations. Settlement is entirely voluntary, and the claimant can refuse any offer if it is not appropriate. Moreover, the parties in negotiations need not disclose the method of calculating their offer or evaluating their claims.

## **B. Attorney Fees as Remedies in Insurance Actions**

### **1. Attorney Fees in Insurance Declaratory Actions**

Court development of attorney fees as a remedy in insurance cases since the millennium is also substantial and merits review here. In 2003, in *Trustees of Indiana University v. Buxbaum*<sup>43</sup> the Court granted attorney fees to third parties who prevailed against a self-insured institution in a coverage dispute. In part, the case is important, because it was later cited by the Montana Supreme Court in *Mountain West Farm Bureau Mut. Ins. Co. v. Brewer*<sup>44</sup> (2003) as legal ground for awarding attorney fees to a prevailing third-party in an insurance declaratory action.

In the *Indiana University* case, three Indiana University students and another Indiana resident were involved in the rollover of a Chevrolet Suburban owned by Indiana University and operated in Montana on a summer research project. Three deaths and a serious injury resulted. In the ensuing lawsuit, the estate of the driver, Jones, demanded defense and indemnity from Indiana University, a self-insurer. Multiple issues developed regarding the University’s duty to indemnify the responsible driver, the University’s status as an insurer, and coverage.

Indiana University brought a declaratory action against the Jones estate and the estate of deceased passenger, Krueger, to resolve the issues. The estates, which sought defense and indemnity coverage from Indiana University, prevailed in the coverage dispute filed by the University, but were confronted with multiple problems in recovering attorney fees. For example, Indiana University was self insured, so it was not an insurance company and did not have an insurance policy contract with the party demanding defense. Accordingly, the insurance exception to the American Rule did not apply to provide a legal basis for attorney fees.

After denying cross motions for summary judgment, the court heard the matter in non-jury trial and found for the estates over the University of Indiana. The judge awarded the estates their costs, expenses and attorney fees but later altered the judgment to delete those amounts on the ground that there was no contractual or statutory basis for such an award. The issue on appeal was whether the District Court erred when it denied the prevailing estates their attorney

fees under the Uniform Declaratory Judgments Act. The Court held attorney fees could be awarded under the “supplemental relief” portion of MCA § 27-8-313 of the Uniform Declaratory Judgments Act.

The court rejected the argument that it could award attorney fees as “costs” under MCA § 27-8-311 of the Uniform Declaratory Judgments Act, since ample precedent establishes that attorney fees and costs are two different remedies in Montana. However, the court found that attorney fees could be awarded as “supplemental relief” under MCA § 27-8-313 of the Act which provides:

Further relief based on a declaratory judgment or decree may be granted whenever necessary or proper. The application therefor shall be by petition to a court having jurisdiction to grant the relief. If the application be deemed sufficient, the court shall, on reasonable notice, require any adverse party whose rights have been adjudicated by a declaratory judgment or decree to show cause why further relief should not be granted forthwith.

The court overruled its decisions in *State ex rel. Dept. of Health and Environmental Sciences v. Lincoln County*,<sup>45</sup> *McKamey v. State*,<sup>46</sup> and *Dorwart v. Carraway*,<sup>47</sup> insofar as they held there is no provision for an award of attorney fees in a declaratory judgment action.

Under the *Indiana University* case, the former “frivolous or malicious” requirement for attorney fees is abandoned if the fees are sought under the “supplemental relief” provision of the Uniform Declaratory Judgement Act, MCA § 27-8-313. Award of attorney fees under that provision only requires a showing of “necessary or proper” under the following guidelines suggested by the court:

1. “Anomalous result” circumstance in which, without an attorney fee award, the insured “would have been worse off than if a declaration of their rights had never been made.” i.e., without attorney fees in the declaratory action, having to bring a bad faith suit to be made whole
2. When no other alternative is available. If the insured must file a declaratory action to obtain the benefit of the insurance, then attorney fees are necessary and proper.
3. If the declaratory action is filed “for purely tactical reasons,” attorney fees may not be appropriate.

## **2. Attorney Fees in Declaratory Actions by the Third-Party Claimant**

*Mountain West Farm Bureau Mut. Ins. Co. v. Brewer*, involved attorney fees where a third-party prevailed in a dispute over indemnity. The parents of the injured minor passenger, Angie Christenson, successfully pressed the third-party declaratory action to enforce coverage of the tortfeasor by Mountain West. Having prevailed, they sought attorney fees and costs under dual theories that (1) the insurance exception to the American Rule should be expanded to provide attorney fees to an injured third-party who prevails in an insurance coverage action against a motor vehicle insurer, and (2) the “supplemental relief” provision of the Uniform Declaratory Judgment Act, § 27-8-313 MCA, allows an award of attorney fees to the third-party

prevailing in such a declaratory action.

On appeal, the Montana Supreme Court said, “We hold that an insured is entitled to recover attorney fees, pursuant to the insurance exception to the American Rule, when the insurer forces the insured to assume the burden of legal action to obtain the full benefit of the insurance contract, regardless of whether the insurer’s duty to defend is at issue.” The court expressly rejected the “transparent” distinction between an insurer’s refusal to defend, for which common law allowed attorney fees, and a denial of coverage for indemnity, for which the courts traditionally have refused attorney fees. In Montana, *Yovish v. USAA*,<sup>48</sup> had deferred to the legislature instead of changing the rule, and the Court in *Brewer* recanted that deferral and overruled *Yovish*.

However, the Court would not expand the Insurance Exception to the American Rule to include attorney fees for third-party claimants who had no contractual relationship with the insurer involved. The court considered the absence of the traditional contractual relationship in third-party cases and found there was no exploitation of inherently unequal bargaining power in such situations, nor was there frustration of any “justifiable expectation of insurance protection” held by the injured third-party. Moreover, the court refused Christenson’s contention that, by enacting compulsory motor vehicle liability insurance, the legislature set a public policy to “extend the right to enforce the insurance contract to injured persons, not just insureds” thereby raising a justifiable or reasonable expectation on the part of the third party of creating a sort of third-party beneficial interest in the coverage. This holding is consistent with those of other jurisdictions on the issue.

However, the court asserted that its holding “does not leave the Christensons without recourse in their attempt to recover their attorney fees.” The court cited the then recently decided *Trustees of Indiana University* case and said, “§ 27-8-313, MCA, authorizes a court to award attorneys fees when the court, in its discretion, deems such an award ‘necessary and proper.’” The court remanded *Brewer* to the District Court for a determination of whether attorney fees and costs were “necessary or proper,” and in what amount.

Counsel should note the breadth of the holding which would appear to apply “when the insurer forces the insured to assume the burden of legal action to obtain the full benefit of the insurance contract, regardless of whether the insurer’s duty to defend is at issue.” Does the holding apply to any benefit or just the benefit of indemnity? Are “benefit” and “indemnity” interchangeable in this context, since an insurance benefit indemnifies the insured for loss? The language is not restricted, and the court could easily have limited the award to legal actions to obtain defense or indemnity under liability policies. The problem being remedied in the holding is forcing the insured “to assume the burden of legal action to obtain the full benefit of the insurance contract.” That problem exists in many situations where the benefit is neither defense nor indemnity for liability.

### **3. No Attorney Fees as Damages in Montana UTPA Actions**

Insurance claimants in third-party bad faith cases were dealt a hard blow in *Sampson v. National Farmers Union Prop. & Cas. Co.*<sup>49</sup> in 2006. There, the Court held that attorney fees are not recoverable as damages in an action brought under Montana’s Unfair Trade Practices Act, MCA §§ 33-18-201 and 242. *Sampson* and *Cebulski* were injured when a car driven by

Langberg collided with theirs. Their *pro bono* attorney offered to settle their claims for \$125,000. Langberg's insurer, NFU, refused. Claimants hired counsel experienced in personal injury claims, and settled the case for \$125,000 two years later after incurring \$43,000 in attorney fees. They then brought action against NFU solely for their attorney fees for NFU's violation of the UTPA, MCA § 33-18-201(6) claiming NFU neglected "to attempt in good faith to effectuate a prompt, fair, and equitable settlement" of the claims when liability was reasonably clear. The issue became whether attorney fees are recoverable as damages in an action brought under Montana's Unfair Trade Practices Act, MCA §§ 33-18-201 and 242. The Court held that attorney fees are not recoverable as an element of damages under Montana's UTPA.

The Court reasoned that, in civil litigation, Montana follows the "American Rule" that, absent a statute or contract that allows attorney fees, each party pays their own attorney fees. The Court found none of the four recognized exceptions to the rule to apply in the case. The Court had already held, in *Goodover* [1993], that the "equitable exception," (where a party gets attorney fees because it was forced into a frivolous lawsuit) doesn't apply in malicious or bad faith situations.

Though the Court allowed attorney fees to third parties in an insurance declaratory action in *Mountain West v. Brewer* (2003), it pointed out that the *Sampson* case was not a declaratory action. The Court recognized that MCA § 33-18-242 provides for recovery of "all damages proximately caused" by the insurer's breach, but noted that the statute did not specify attorney fees, and the Court believed the legislature could and would have done so if it meant to allow attorney fees. *Sampson's* and *Cebulki's* \$43,000 in attorney fees illustrated perfectly that, for insureds in bad faith actions, attorney fees could be "all damages proximately caused." The Court's refusal to allow attorney fees proximately caused by the insurer's bad faith conduct as an element of damages in a third-party statutory bad faith case was a bitter pill to swallow.

#### **4. Attorney Fees in the Underlying Action as Damages in the Bad Faith Action?**

Readers should note that Judge Sandefur, in Montana's Eighth Judicial District in *Jacobsen v. Allstate*<sup>50</sup> in 2006, raised the possibility that a plaintiff in a third-party UTPA action in Montana may recover attorney fees, incurred in relation to the underlying claim, by extension of the equitable or insurance exception to the American Rule. Sandefur, in denying Allstate's motion for summary judgment on such attorney fees, noted that the Montana Supreme Court has never "squarely addressed the issue." He reasoned that extending the insurance exception to attorney fees suffered by the third party in the underlying action (not the UTPA claim) would do no damage to the Court's holding in *Sampson*. The case is on appeal, and Larry Anderson has appeared and is briefing the case on behalf of the MTLA Amicus Committee.

### **C. The Reasonable Basis Defense Under MCA § 33-18-242(5)**

#### **1. Dispute Over Duty as a Reasonable Basis**

Subsection (5) of the UTPA, MCA § 33-18-242 provides a complete defense in a bad faith case to an insurer which "had a reasonable basis in law or in fact for contesting the claim or the amount of the claim. . . ." This subsection has produced and will continue to produce a parade of defenses submitted as a reasonable basis for denying claims. Insurance defense

counsel have persuaded trial courts in the state to place on the interrogatory or special verdict forms the final question, “Did the defendant (insurer) have a reasonable basis for contesting the claim or the amount of the claim?” As has happened, the jury can answer every question in favor of the plaintiff and then answer “yes” to the question of reasonable basis, and the insurer wins. Following are cases that shed light on the reasonable basis defense to insurance bad faith.

*Redies v. Attorney Liability Protection Society*<sup>51</sup> (2007), involved a bad faith claim arising out of the handling of a legal malpractice claim by the Attorneys Liability Protection Society (ALPS), a captive legal errors and omissions insurer. Janet Redies filed suit against ALPS alleging that the company had engaged in unfair trade practices by failing to promptly settle a legal malpractice action she had brought against one of ALP’s lawyer insureds two years earlier. Redies had suffered brain damage in a bicycling accident and was, at one point, so disabled that her family had a permanent conservator appointed for her substantial assets. The lawyer hired by the conservator for the estate recommended disposing of all her assets so that she would qualify for Medicaid and SSI coverage. The conservator did so, but, Redies eventually recovered to the point that she was able to handle her own business affairs. When she realized that her assets had been disposed of and that the lawyer could have recommended a “self sufficiency trust” that would have allowed her to retain the assets and still get the Medicaid and SSI, she brought a claim against the lawyer who advised disposing of the assets.

Redies’ lawyer sent an evaluation of liability in the case against ALPS’s insured to ALPS. ALPS in turn commissioned its own professional evaluation of Redies’ claims. That evaluation raised several potential defenses most important of which was the possibility that, under Montana law, Redies might not be considered the client of the lawyer hired by the conservator. ALPS immediately denied liability, and Redies filed suit against the lawyer alleging negligence and breach of fiduciary duty. The district court ruled on summary judgment that the lawyer owed Redies a duty of care as a matter of law, and later, the parties settled.

Redies brought suit against ALPS alleging statutory violations of the UTPA, MCA § 33-18-201 and for breach of the implied duty of good faith and fair dealing in failing to settle her claims. ALPS principle defense was that it had “a reasonable basis in law or in fact for contesting the claim” under MCA § 33-18-242(5).

A key issue in the case was whether the “reasonable basis in law or in fact” defense is a question of fact or law. The Montana Supreme Court said, “[W]hile the assessment of reasonableness generally is within the province of the jury (or the court acting as fact-finder), *Dean*, 263 Mont. at 389, 896 P.2d at 258, reasonableness is a question of law for the court to determine when it depends entirely on interpreting relevant legal precedents and evaluating the insurer’s proffered defense under those precedents.”

The Court reasoned that this is in keeping with the principle that the jury does not decide or determine the law and also honors the statute which provides that “An insurer may not be held liable under this section if the insurer had a reasonable basis in law. . . for contesting the claim or the amount of the claim.” MCA § 33-18-242(5).

The second issue was whether, at the time ALPS evaluated the claim against its insured, it had a reasonable basis for believing that the insured did not owe a duty of care to Redies as a client. The Court held ALPS had a reasonable basis at that time for believing that its insured lawyer owed no duty to Redies as a client. The Court reasoned that the first thing a claimant in a

professional malpractice suit must establish is that the professional owed her a duty. At the time of evaluation, there was no Montana law recognizing any duty of the attorney to the beneficiary of the conservatorship, but only to the conservator and estate. Hence, the insurer may raise issue of whether any duty is owed as a reasonable basis for denying coverage or a benefit.

## **2. Defense Verdict Not Conclusive on “Reasonable Basis” Defense**

In *Graf v. Continental Western Insurance Company*<sup>52</sup> (2004), the question was whether one can bring an action against the third-party insurer for violation of the UTPA if the insurer prevailed in the underlying action? Graf was stopped at a traffic light in Great Falls when a semi-tractor owned by Goosebill Ranch and pulling two trailers was unable to stop on a downgrade, ran through two red lights, and caused a multiple car collision injuring Graf. Goosebill’s insurer, Continental, took what looked like an unreasonable position that liability was not reasonably clear based on the opinions of its trucking expert. Graf’s pretrial motion for summary judgment on liability was denied, and the jury returned a defense verdict. Subsequently, another victim of the same accident, Cloutier, sued. At the end of the evidence, Cloutier was granted a directed verdict that Goosebill was negligent as a matter of law, and the jury returned a verdict for damages. Graf then settled on appeal, reserving an action for “bad faith” against Continental. Graf sued Continental for bad faith, and the company argued it had, by reason of the verdict favorable to its insureds, the statutory “reasonable basis” defense to the UTPA claim.

However, on appeal, the Montana Supreme Court held that a defense jury verdict in the underlying suit does not, as a matter of law, establish a “reasonable basis” defense under the UTPA. The Court noted that the issues in the UTPA claim and the underlying claim are separate and distinct, i.e., whether the tortfeasor negligently caused the accident as opposed to whether the insurance carrier conducted a reasonable investigation and attempted in good faith to effectuate settlement of the claim when liability had become reasonably clear. “The UTPA standards focus on what the insurer knows at a particular point in time—before trial, during the investigative settlement stage.” \* \* \* “The UTPA is designed to address these very inquiries; that is, was there a reasonable investigation and did the insurer make a good faith attempt to effectuate a prompt and fair settlement of a claim in which liability had become reasonably clear?” Accordingly, the defense verdict in the underlying suit does not collaterally estop the UTPA claim, because estoppel requires that the issues be identical. Hence, the insurer can commit bad faith in its handling of the claim even if its final conclusion is correct and the jury in the underlying case agrees.

## **3. Rejecting “Comparative Bad Faith” as a “Reasonable Basis” Defense**

The Court has also dealt with the question of whether the insurer can claim as its “reasonable basis” comparative bad faith on the part of the insured. As reported in the earlier article on bad faith, the Court in *Stephens v. Safeco Ins. Co. of America*,<sup>53</sup> held the contract between an insured and insurer to be a “special relationship” that would support a claim for bad faith. The Court said:

[I]nsurance companies have a duty to act in good faith with their insureds, and this duty

exists independent of the insurance contract and independent of statute. If this duty is breached the cause of action of the insured against the insurer sounds in tort.

However, the Court in *Stephens*, held that, because the insured owes no such duty to the insurer, the insured cannot act in bad faith.

In *Burton v. Mountain West Farm Bureau Mut. Ins. Co.*<sup>54</sup> (2003), in a bad faith case, federal Judge Molloy refused to recognize, “comparative bad faith” as a “reasonable basis” for the insurer’s denial of the claim.

Burton was injured as a passenger in a car driven by Truscott and insured by Mountain West. After he settled with Truscott, he asserted a first-party claim against Mountain West for failing to inform him that the Medical Pay coverages on each of Truscott’s three other cars were available to him. He asserted third-party claims that the insurer made him agree that the stacked medical payments constituted an advance against any future recovery, and that it failed to fairly and promptly investigate his claim. The first-party claims arose under the Unfair Claims Settlement Practices Act, MCA § 33-18-201 and 242. The third party claim was a common law insurance bad faith claim. Mountain West plead a Second Affirmative Defense that Burton’s recovery under the common law bad faith claim is limited by “comparative bad faith,” and argued that Burton’s first and third-party claims sound in tort.

The Federal District Court granted Burton’s motion to strike the comparative bad faith affirmative defense asserting that plaintiff’s conduct is only a defense if it is a cause of his damage, not if it is part of the insurer’s “reasonable basis” for refusing to pay the claim. Judge Molloy said, if the plaintiff owed and breached a duty to the insurer, the insurer could file a counterclaim and meet its burden of proving duty, breach, cause and damage. The insurer can also adequately defend itself by presenting Burton’s conduct as a reasonable factual scenario.

#### **4. Timeliness as a “Reasonable Basis” for Defense**

The UTPA requires that the insurer “promptly” act upon claim communications, settle claims, and provide a reasonable explanation for denial of claims. Hence unreasonable delay in performing those functions is a common basis for complaints of bad faith in claims handling. In 2001, the Court in *Ensey v. Colorado Casualty*<sup>55</sup> provided some guidance as to whether delay is reasonable.

Ensey, an independent drywall contractor who fell from a ladder at a construction site, sought advance payment of medical and living expenses. Colorado Casualty immediately responded that it was investigating, and their attorney sent a letter 11 days after the demand confirming representation of the carrier and intent to respond. Eight weeks after the initial demand, Colorado Casualty’s attorney sent a letter refusing the advances on the ground that liability was not reasonably clear. Defense counsel indicated that investigation revealed that other appropriate devices were available to safely perform the work, but that Ensey chose not to use them.

The Montana Supreme Court, when presented with the question of whether the insurer’s response violated the MUTPA, held that it did not. It said the letter from the defense attorney met the Unfair Trade Practices Act requirement that the insurer “promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial

of a claim or for the offer of a compromise settlement.” The Court noted that the insurer informed the claimant of (1) the legal basis for its denial (that liability was not reasonably clear), (2) the factual basis for its conclusion that liability was not reasonably clear (other appropriate devices were available to safely perform the work, but claimant chose not to use them.), and (3) promptly informed claimant that it was denying the claim. The Court did not seem concerned by the fact that the insurer’s response to a request for advance payment of medical expenses was made two months and one week after the request.

### **5. Summary Judgment Usually Inappropriate in Reasonable Basis Defense Case**

In *Shelton v. State Farm*,<sup>56</sup> Shelton amended her complaint against State Farm for UIM benefits to add claims for punitive damages and bad faith under the MUTPA, MCA § 33-18-201. The claims were bifurcated and the UIM claims settled. Then, State Farm was granted a summary judgment on the MUTPA claims, and Shelton appealed.

The Montana Supreme Court held it error to grant summary judgment, because issues of fact existed regarding whether State Farm conducted a reasonable investigation and attempted in good faith to effectuate a prompt, fair, and equitable settlement of her claim where liability was reasonably clear. In UTPA cases, it should be very hard for an insurer to prevail on summary judgment because the claims are commonly based on such acts as the insurer’s dereliction of its duty to conduct a reasonable investigation, promptly settle claims, affirm or deny coverage within a reasonable time, or attempt to effectuate prompt, fair, and equitable settlements of claims where liability is reasonably clear. In each such case, the insurer will be denying the conduct, and it is the task of plaintiff’s counsel to set out for the court each of the conducts that are at issue in the claim thereby establishing a genuine issue of material fact.

## **D. Other Bad Faith Developments**

### **1. ERISA Preemption of Montana Bad Faith Law**

The bane of existence for insurance claimant’s counsel is ERISA, the Employment Retirement Income Security Act passed by Congress in 1974<sup>57</sup>. Congress wanted to encourage employers to provide health and disability insurance plans for their employees. In essence, one of the promises embodied in the legislation is that, if the employer provides such a plan, plan beneficiaries enforcing promises under the policies would be limited to remedies set forth in ERISA and prohibited from using state law remedies. Consequently, a set of inadequate remedies in the federal statutes displaced effective state remedies such as insurance bad faith claims and punitive damages. Realistically, there are no effective remedies for the plan claimant when the employer’s insurer wrongly refuses to pay for a \$7,000 medical procedure. The plan claimant might win a breach of contract claim after three years of litigation and be awarded \$7,000 plus interest and a chance of getting a modest award of attorney fees. This provides little incentive to the insurer to timely or fairly pay claims.

However, this congressional mandate is in conflict with McCarran-Ferguson Act,<sup>58</sup> the foundation of insurance regulation, which in 1947 established that the “business of insurance” would be regulated by the states and not the federal government. Hence, Congress fitted ERISA with a “savings clause” that allows state laws that regulate insurance to operate regardless of

ERISA's prohibitions. For counsel desperate to have an adequate remedy for wrongful conduct of an employment-based insurer protected by ERISA, this presented the possible argument that an insurance bad faith claim was actually state regulation of insurance and not, therefore, prohibited by ERISA. The argument is that statutory and common law bad faith claims are state regulation of insurance and therefore exempt from the prohibitions of ERISA, an idea that seems most logical to counsel who have spent their careers requiring insurers to keep their promises and conduct themselves by certain standards.

Hence, in *Elliot v. Fortis Benefits Ins. Co.*<sup>59</sup> (2001), brought in Judge Cebull's Court in the Montana Federal District, counsel pressed the argument that the remedy of an independent action under MCA 33-18-242 is "regulation of insurance" which is not preempted by ERISA. The insurer, Fortis, denied disability benefits to a paralegal employee, Stephanie Elliot, who was in complete remission from breast cancer at the time she applied for disability insurance. When the cancer recurred and Elliot filed a claim for disability benefits, Fortis denied the claim alleging she had a preexisting condition. Elliot pressed an "independent action" against Fortis under MCA § 33-18-242 for violations of the Montana UTPA.

However, the Court held that insurance claims arising under Montana's UTPA, MCA § 33-18-201 and 242, against ERISA plans are preempted by the "broad sweep" of ERISA's preemption clause, 29 U.S.C. § 1144 (a). The Court confirmed that ERISA has a savings clause for "any law of any state which regulates insurance"<sup>60</sup> and found that the UTPA is a form of "regulation." But, Judge Cebull held that this was not the "business of insurance" as used in the McCarran-Ferguson Act and, therefore, not saved. The factors the U.S. Supreme Court has determined decide whether a matter regulated by state statute is the "business of insurance" are:<sup>61</sup>

- (1) whether the state law at issue has the effect of transferring or spreading a policy holder's risk
- (2) whether the state law is "an integral part of the policy relationship between the insurer and the insured"
- (3) whether the rule is limited to entities within the insurance industry.

Judge Cebull, followed Ninth Circuit precedent of *Greany v. Western Farm Bureau Life Ins. Co.*<sup>62</sup> (1992) which had already held that "Montana Unfair Claims Settlement Practices statutes do not 'regulate insurance' as discussed in [the savings clause], but are civil enforcement provisions." Accordingly, he found that the UTPA does not regulate the "business of insurance", and does not then fall into the savings clause of ERISA. Therefore, the UTPA is preempted under ERISA plans, and Montanans under ERISA plans lose the benefit of this State's significant body of bad faith law.

## **2. ERISA and the "Discretionary Clause"**

The other development in ERISA is the appearance of the "discretionary clause" in ERISA plans which gives the insurer the unfettered right to make benefit determinations and interpret plan terms. In *Sanford v. BP/Amoco Chemical Co.*<sup>63</sup> (2006), Federal Judge Cebull followed 9<sup>th</sup> Circuit authority in giving the clause effect. There, Value Behavioral Health, Inc. refused inpatient hospital treatment for a female college student who attempted suicide while

suffering from eating disorders and depression. The reviewing physician for the plan administrator repeatedly found facts completely at odds with what the treating physicians were observing.

The ERISA plan involved contained a discretionary clause giving Value Behavior Health, Inc. discretionary authority to determine the eligibility for benefits or to construe the terms of the plan. Under ERISA case law, the court must give substantial deference to the plan administrator's decision and can only review on an "arbitrary or capricious" standard. In *Sanford*, Judge Cebull simply held that the decision of the administrator was arbitrary and capricious and based on clearly erroneous findings of fact.

State Insurance Commissioner, John Morrison and many other state insurance commissioners have prohibited the use of the discretionary clause in health and disability plans in their respective states. The industry engaged in litigation in heavily populated states including New York, New Jersey and California but settled and dropped the clause from policies in those states. The industry instead, elected to sue John Morrison in State and Federal Courts in Montana on claims that his action in prohibiting the discretionary clause is preempted by ERISA. Those cases, which are being defended by MTLA member, Jim Hunt, are pending as this article is written.

### **3. The Guaranty Fund Gets Immunity from Bad Faith**

In 2007, the Court ruled that the Montana Insurance Guaranty Association (MIGA) is not subject to claims for bad faith for its handling of claims under the guaranty fund. In *Boettcher v. Montana Guaranty Fund*,<sup>64</sup> Boettcher shattered both heels while painting Kaste's commercial building. Kaste's insurer, Legion Insurance Company, became insolvent, and Boettcher's claim was handled by the MIGA. Western Guaranty Fund Services and its adjuster, Reed, handled claim administration for MIGA. MIGA ultimately paid Boettcher the \$300,000 statutory limit from the guaranty fund, but Boettcher alleged that MIGA engaged in a two-year delay, withheld payment and required unnecessary litigation causing Boettcher to incur substantial attorney fees.

Boettcher filed a declaratory action seeking a ruling that: 1) MIGA has all the rights, duties, and obligations of the insolvent insurer including statutory and common law obligations of good faith; 2) Limits of liability of MIGA under the guaranty fund act apply only to its contractual obligations and not to "extra contractual" obligations like insurance bad faith claims; 3) persons hired to administer claims on behalf of MIGA are not protected from liability by the act; 4) any immunity for "extra contractual" claims granted to MIGA violates equal protection and due process under the state and federal constitutions.

The district court granted summary judgment to MIGA, Western Guaranty, and Reed on the ground that the MCA § 33-10-110 granted them immunity from all such liability. On appeal, the court held that the Guaranty Fund (MIGA) is protected by 33-10-110 from liability for statutory or common law bad faith claims. However, it also held that the 2001 Guaranty Fund statute did not protect claims adjusters and administrators from liability for statutory and common law bad faith claims. The Court's reasoning was that §33-10-110, MCA (2001), provides that there is no liability on the part of, and that no cause of action of any nature may be brought against "any member insurer, the association or its producers or employees, the board of directors, or the commissioner or his representatives. . . ". The immunity given applies to "any

action taken by them in the performance of their powers and duties under this part.” The Court in *Howell v. Glacier General Ins. Co.* (1994)<sup>65</sup> had determined that MIGA’s duty was to pay “covered claims” as defined by statute and held that covered claims did not include claims for attorney fees. MIGA stands in the shoes of the insolvent insurer only to the extent of the insurer’s obligation to pay “covered claims” and not to the extent the insurer would be liable for bad faith. Therefore, statutory or common law bad faith claims fall outside the definition of “covered claims” in §33-10-102(2)(a), MCA.

However, the Court also held the statutory immunity granted the fund extends to “insurance producers or employees” but not to claims adjusters and administrators who cannot be read into the statute. Consequently, summary judgment for Western Guaranty and Reed was reversed, and the claims for bad faith against them were remanded. We should note that the Court declined to decide whether the statutory immunity violates substantive due process or equal protection as that issue was not perfected for appeal.

#### **4. The Statute of Limitations Trap in Bad Faith Cases**

The 2004 case of *O’Connor v. National Union Fire Ins. Co. of Pittsburgh, PA*,<sup>66</sup> illustrates the danger and unfairness inherent in the legislature’s specification of differing statutes of limitations when it enacted MCA § 33-18-242 (7)(a) & (b). Subsection (a) dictated that the statute of limitations for an “insured” commenced “within 2 years from the date of the violation of 33-18-201,” while Subsection (b) said that, for a “third-party claimant,” the statute commenced “within 1 year from the date of the settlement of or the entry of judgment on the underling claim.” Hence, both the periods and the events that trigger the clock are very different for first-party and third-party claimants.

O’Connor suffered a back injury in a workplace slip-and-fall at Wal-Mart in Billings in August 1993. She won a Workers’ Compensation Court order that the carrier pay for a surgery and provide temporary total disability benefits in May 1995. There was no final settlement or judgment of permanent disability at that time.

In October 1996, O’Connor filed a federal action for violation of the UTPA for denying her claim and delaying her surgery. The claim was dismissed as premature under MCA § 33-18-242(5)(b) which forbids a third-party from filing “an action under this section until after the underlying claim has been settled or a judgment entered in favor of the claimant on the underlying claim.” (Note that O’Connor was a third-party claimant, the workers comp insurer being the liability insurer for her employer.)

After *Brewington* (1999), held that third-party common law bad faith still existed, O’Connor again filed a federal UTPA and common law bad faith claim. However, the federal court, interpreted *Brewington* to mean each interim judgment on work comp benefits was an “underlying claim” which had therefore started the statute to run in May 1995. The Court dismissed for statute of limitations, and, on appeal, the Ninth Circuit certified the following question to the Montana Supreme Court.

For statute of limitations purposes, do statutory and common law bad faith claims against an insurer, predicated on actions taken in the adjustment of a workers’ compensation claim, accrue when the Montana Workers’ Compensation Court enters a judgment

ordering the insurer to pay for a previously denied benefit, but leaves unresolved the ultimate determinations of the extent and duration of the worker's disability?

The Court held that the statute was triggered on entry of judgment on benefits by the Worker Compensation Court. The Court noted that a third-party bad faith claim may not be brought under the MUTPA "until after the underlying claim has been settled or a judgment entered in favor of the claimant on the underlying claim."<sup>67</sup> However, the MUTPA does not define "underlying settlement." The court synthesized the prior controlling cases of *Grenz* (1990), *Poteat* (1996) and *Brewington* (1999), by saying "we determine the accrual date of a bad faith claim arising out of a separate and independent disputed issue by determining whether that particular issue has been ultimately resolved, regardless of the existence or absence of a resolution of other issues within the workers' compensation case." The Court agreed with the defendant insurer that "[S]tatutory and common law bad faith claims arising out of the handling of workers' compensation claims accrue at the time each individual dispute giving rise to the bad faith claim is resolved by settlement or WCC judgment regardless of whether other issues remain in dispute in the workers' compensation case." The court found the rule against allowing a bad faith action to proceed at the same time as the underlying action in civil case set forth in *Fode* (1986) to be distinguishable on the ground that *Fode* wasn't a workers' compensation case and "of limited relevance" in light of *Grenz*, *Poteat*, and *Brewington*.

Justices Cotter, Leaphart and Regnier dissented that work comp bad faith needs a "bright line" and that it should be the point in the overall claim where liability and extent and duration of disability have been resolved by judgment or settlement. They predict that "claimants will be required to file a cause of action covering any perceived act of bad faith that occurred prior to entry of each interim judgment." \* \* \* "The insurer's course of conduct will have to be broken into artificial subsets for each successive bad faith lawsuit. \* \* \* the court will have to figure out what portion of the claims' file of the insurer should be produced in discovery..." The *O'Connor* case's interpretation of the arbitrary time limits and triggers of MCA 33-19-242(7)(a) & (b) is frightening for even the most careful attorneys.

#### **4. Who is a Third-Party for Third-Party Actions**

*American Financial, Inc. f/k/a First National, Inc. v. American States Ins. Co.*<sup>68</sup> (2001), limited who could be a "third party" for purposes of a bad faith claim at common law or under the statute, MCA § 33-18-201. The Court held that, in order to bring a third party bad faith claim, one must show "that they were a third-party claimant on the liability policy in the underlying case" and that, "because of the wrongful denial of coverage by the insurer, the third-party was injured."

*American Financial, Inc. (f/k/a First National, Inc.)* was a lender advising the West Yellowstone School District which was building a new school. The lender recommended that the project architects, be included as additional insureds on a \$2,000,000 policy they recommended be required of the general contractor. After review of the appropriate insurance certificate, American advised the school district that the architects were insured as recommended.

When design and construction problems developed, the school district made demands on ASI for negligence of the contractor, Beck, and the architects. ASI wrongly denied coverage for

the architects claiming ASI never received the Certificate of Insurance naming the architects as additional insureds and that an endorsement to ASI's policy excluded professional negligence.

The school district sued the insurer and amended to name the lender, American Financial for negligently advising them that the architects were covered. However, discovery disclosed that an ASI employee had in fact received the certificate. Also the court ruled that the endorsement ASI issued and backdated was void. American Financial then successfully moved for summary judgment on the negligence claim against it on the ground that the school district had actually received the coverage and advice sought from ASI.

American Financial then sued ASI on multiple claims including common law bad faith. ASI moved for summary judgment on the ground that American Financial was not a "third party" which could bring a bad faith claim at common law or under the statute. The agreed reasoning that "Extending third-party status to peripheral parties affected by the denial of coverage, but who were not themselves a claimant against the liability policy, would lead to a result where potentially anyone impacted by a bad faith denial of coverage could sue the insurance company." The court distinguished *O'Fallon* (Mont. 1993) in which the claimants were the driver and passenger injured in an accident with the insured party and pressing claims under that insured's policy before bringing a claim against that insurer. The court could find no authority for extending the third party status to American Financial.

#### **d. Evidence in the Statutory Bad Faith Action**

The Federal District Court in Montana has taken a little of the sting out of the fact that only certain kinds of insurer conduct prohibited by the UTPA, MCA § 33-18-201 are actionable under MCA § 33-18-242. Judge Molloy held in *West v. State Farm Mut. Auto. Ins. Co*<sup>69</sup> (2000), that evidence relating to those subsections of the Unfair Claims Settlement Practices Act, MCA § 33-18-201, that do not support an independent cause of action under MCA § 33-18-242 may still be admissible to prove subsections that do support an independent cause.

For over a year, State Farm made no offer in response to West's demand for her UIM limits. West filed a federal complaint alleging numerous breaches of the Unfair Claims Settlement Practices Act, MCA § 33-18-201, some of which gave rise to independent causes of action under MCA § 33-18-242. She also alleged the following breaches of 201 that did not support causes of action under 242:

- \*\* Compelling her to institute litigation through its penurious policies by offering an inappropriately low amount in settlement (33-18-201[7])
- \*\* Failing to provide a reasonable explanation for its refusal to pay (201[14])
- \*\* Failing to acknowledge and act promptly upon her communications (201[2])
- \*\* Failing to adopt and implement reasonable standards for prompt claims investigation (201[3])

State Farm moved for summary judgment and motion in limine to block any evidence of those claims that did not support independent causes of action, and Judge Molloy refused. He found the standard to be whether the conduct alleged in the claims that do not support the action is relevant to the claims that do support the action. Hence, if one can show relevance, one can

successfully offer evidence that won't support a claim under MCA § 33-18-242. This may allow the claimant to develop for the jury the whole picture of the insurer's misconduct.

### III. Conclusion

It is likely that the turbulence in development of insurance bad faith brought on by the legislature's enactment of MCA § 33-18-242 in 1987 is settling. Montana's bad faith structure with its first-party statutory independent actions and third-party common law and statutory actions is likely here to stay. Litigation of what constitutes a "reasonable basis" defense for insurers will continue, while claimants will struggle with restrictions on attorney fees in bad faith actions. As always, insurance bad faith law is only as good as the remedies it provides for enforcement.

1. The author is grateful for review, comment and editing by Pat Sheehy and Gary Zadick.
2. Gregory S. Munro, "*Development and Status of Insurance Bad Faith in Montana*," TRIAL TRENDS, 36 (Summer 2000).
3. *See, Id.*
4. 210 F.Supp.317 (D. Mont. 1962), *aff'd sub nom., National Farmers Union Property & Cas. Co. v. O'Daniel*, 329 F.2d 60 (9<sup>th</sup> Cir. 1964).
5. 374 P.2d 96 (Mont. 1962).
6. 423 P.2d 598 (Mont. 1967).
7. Ch. 286, L. 1959.
8. MCA § 33-18-201; Sec. 1, Ch. 320, L. 1977.
9. *Id.*
10. 643 P.2d 198 (Mont. 1982).
11. 655 P.2d 970 (Mont. 1982).
12. 658 P.2d 1065 (Mont. 1983).
13. 592 P.2d 329 (Cal. 1979).
14. 682 P.2d 725 (Mont. 1984).
15. Sec. 3, Ch. 278, L. 1987; MCA § 33-18-242.

16. Subsection (7).
17. *Id.*, subsection (5).
18. Ch. 627, L. 1987; MCA § 27-1-221.
19. 676 P.2d 162 (Mont. 1984).
20. 791 P.2d 767 (Mont. 1990).
21. 852 P.2d 565 (Mont. 1993).
22. 1998 MT 343, 973 P.2d 804.
23. 859 P.2d 1008 (Mont. 1993).
24. *Thomas*, *supra*, note 22.
25. 1999 MT 312, 992 P.2d 237 (Mont. 1999).
26. 2000 MT 153, 2 P.3d 834 (Mont. 2000).
27. 951 P.2d 987 (1997).
28. Kenneth Abraham, INSURANCE LAW AND REGULATION, 621 (2d ed. 1995).
29. MCA § 33-18-242(4).
30. 951 P.2d 987.
31. MCA § 33-18-201 (6) & (13).
32. *Safeco*, *supra*, note 26.
33. 2000 MT 153, 2 P.3d 834.
34. 2000 MT 150, 3 P.3d 626.
35. 192 F.Supp.2d 1071 (Dist. Mont. 2002).
36. 833 P.2d 191 (Mont.).
37. 2003 MT 122, 70 P.3d 721.
38. 73 Fed. Appx. 254 (9<sup>th</sup> Cir. Mont. 2003).
39. *Safeco*, *supra* note 27.

40. 2007 MT 85.
41. MCA § 27-1-307 & 308.
42. *Id.*
43. 2003 MT 97, 69 P.3d 663.
44. 2003 MT 98, 69 P.3d 652.
45. 178 Mont. 410, 584 P.2d 1293 (1978).
46. 268 Mont. 137, 885 P.2d 515 (1994).
47. 1998 MT 191, 966 P.2d 1121.
48. 243 Mont. 284, 794 p.2d 682 (1990).
49. 2006 MT 241.
50. Cause no. ADV-03-201(d), Oct. 14, 2006.
51. 2007 MT 9.
52. 2004 MT 105, 89 P.3d 22.
53. 852 P.2d 565 (Mont. 1993).
54. 214 FRD 598 (2003).
55. 2001 MT 152, 30 P.3d 350.
56. 2007 MT 132.
57. 29 USCS §§ 1001 *et seq.*.
58. 15 U.S.C. §§ 1011-15.
59. 29 M.F.R. 277 (2001).
60. 29 U.S.C. § 1144 (b) (2) (A).
61. *Unum v. Ward*, 526 U.S. 358, 373 (1999).
62. 973 F.2d 812, 819 (9<sup>th</sup> Cir. 1992).
63. CV 04-46-BU-RFC, 3/20/06.

64. 2007 MT 69.
65. 868 P.2d 568 (Mont. 1994).
66. 2004 MT 65, 87 P.3d 454.
67. MCA § 33-18-242(6)(b).
68. 29 M.F.R. 287, CV-00-15-BU-RFC (2001).
69. 27 MFR 219, CV-99-55-GF-DWM.